



Rating Presentation for the State of Tennessee

June 2003



List of Participants

 Phil Bredesen	Governor
 John G. Morgan	Comptroller of the Treasury
 Steve Adams	State Treasurer
 Riley C. Darnell	Secretary of State
 Dave Goetz	Commissioner of Finance & Administration
 Mary-Margaret Collier	Director of Bond Finance
 Marlin L. Mosby	Public Financial Management, Inc.



Tennessee's New Fiscal Strategy

- Elected to run government like a business, guarantee fiscal house is in order
 - As a former CEO, I'm uniquely suited to the challenge
- We're headed in the right direction
 - First four months focused almost singularly on imposing new standard of fiscal discipline, responsibility
 - Working to bring new management principles to bear on the running of state government
 - Tackling impediments to financial success head-on (i.e. TennCare, court orders, etc.)
- Ultimately the goal is very straightforward:
 - Get Tennessee on sound fiscal footing
 - Instill confidence in long-term financial stability
 - Get the "talk" right about Tennessee again



Blueprint for Fiscal Stability

- (1) Balanced, responsible budgets that get state spending in line with available revenues
 - For the time being, the public has clearly stated its desire for smaller government, no new taxes. Tennessee must learn to live and operate successfully within those confines.
- (2) Insist on highest possible standards of fiscal responsibility
 - Conservative revenue projections
 - Protect, rebuild reserves
 - Spending restraint
 - Conservative approach to issues like the lottery to protect against the creation of unfundable entitlements
 - Where there is new spending, calibrated investment strategy (emphasis on education, economic development, safety)



Blueprint for Fiscal Stability

(3) Get TennCare under control

- Program innovative, but broken. For state's long-term economic success, costs must be brought under control
- Needs more than tinkering around the edges – requires fundamental restructuring
- Four step turn-around process underway:

Status	Next Steps
COMPLETED	Step 1: Get relief from federal government. <ul style="list-style-type: none">• Negotiated changes waiver to remove hard cap on federal funds (\$175M benefit to state)
UNDERWAY	Step 2: Get out from under court orders <ul style="list-style-type: none">• Negotiated standstill agreement on Grier consent decree• Working to negotiate resolution to other lawsuits, consent decrees
UNDERWAY	Step 3: Cut program costs. <ul style="list-style-type: none">• <u>Pharmacy</u>: Putting PDL in place, will hire pharmacy benefits manager this fall• <u>Third Party Liability</u>: Will have contractor in place by October 31, 2003• <u>Disease Management</u>: Protocols for diabetes, COPD in place by this fall
UNDERWAY	Step 4: Restructure TennCare <ul style="list-style-type: none">• Restructuring program to be proposed in next legislative session



Blueprint for Fiscal Stability

(4) Reorder the state's priorities, bring focus to what we do

- All-hands-on-deck approach to economic development
 - Eight major jobs announcements made in the first quarter alone
 - Jobs cabinet bring the full muscle of the state to bear on the issue
 - No “one size fits all” approach – regional strategies being developed
- Top priority on education. K-12 spending the core of this year's new spending. Longer-term, K-12/higher education investments essential
- Working to get out from under court orders
 - Department of Children's Services
 - Mental Retardation
 - TennCare



Blueprint for Fiscal Stability

- These steps show we're serious about moving Tennessee's economy forward
- Help put us on stable path for long-term viability, growth
- Hopefully the result of these initiatives begin to bear fruit and Tennessee's ratings outlook can be improved



Snapshot of the State's Economic Indicators

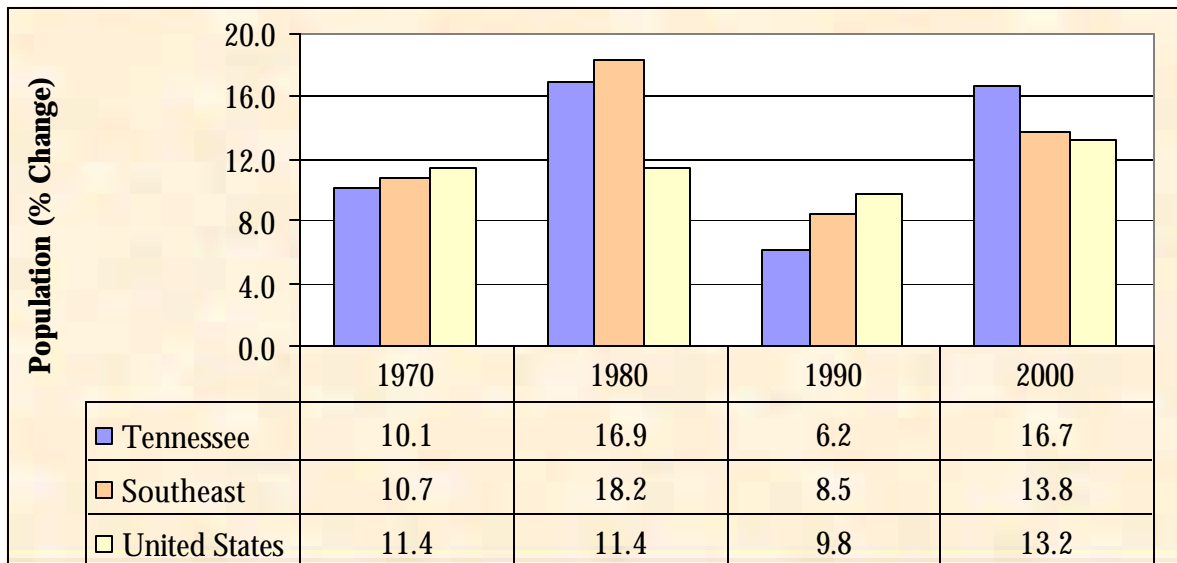


Economic Snapshot

- Despite national economic slowdown, Tennessee continues to show signs of a relatively strong economy
 - Population growth on the rise, outpacing national and regional averages
 - Economic growth spread across the state vs. isolated to individual areas
 - Employment base diversified, balanced
 - Unemployment below national and regional averages

Tennessee's Population Growth

- For the past ten years, Tennessee's population growth has been on the rise, outpacing national and regional averages



Source: U. S. Census Bureau

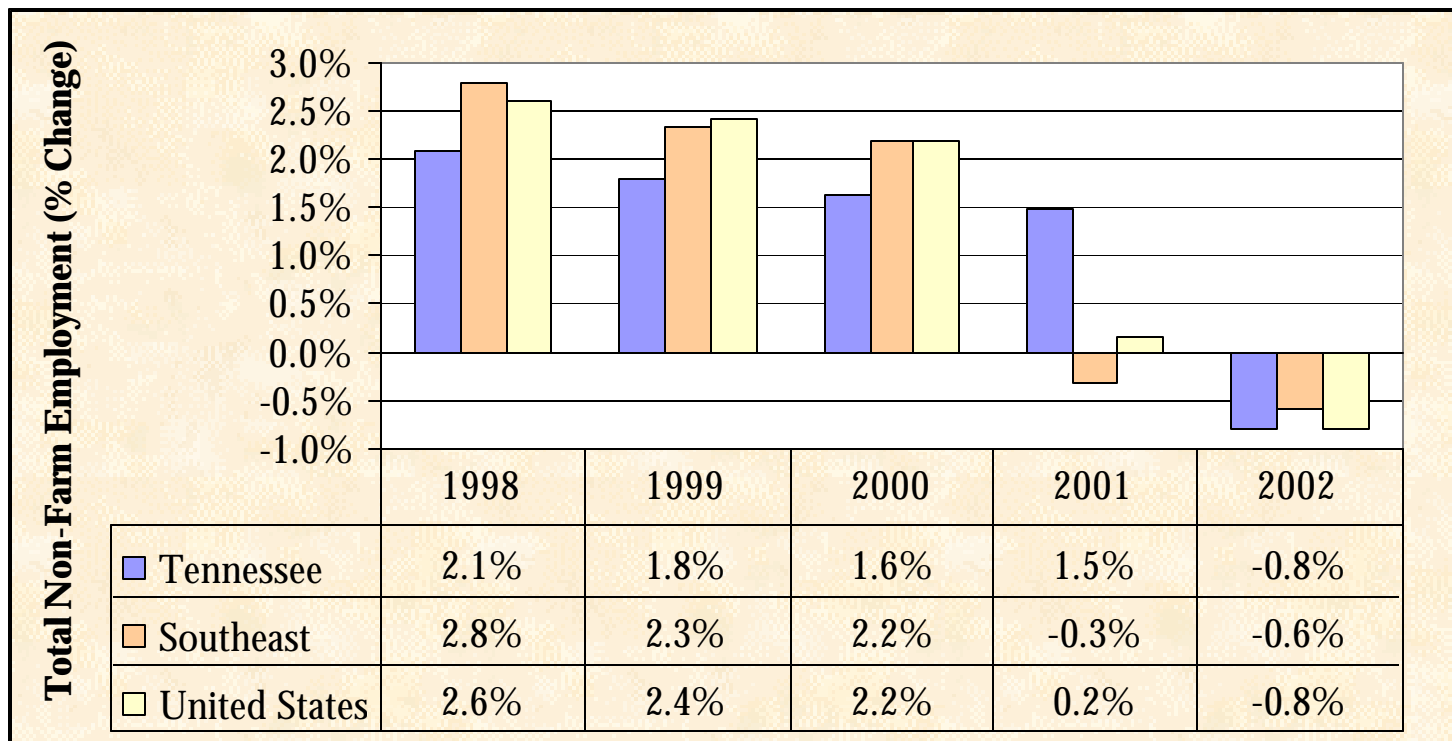
- The age distribution of Tennessee's population mirrors that of the Nation

% Population by Age Group For year ended 2002			
Age Group	Tennessee	Southeast	United States
18-24	9.8%	10.1%	9.8%
25-34	13.9%	13.5%	13.7%
35-49	22.9%	22.5%	22.9%
50+	29.0%	27.2%	28.0%

Source: Sales & Marketing Survey of Buying Power

Tennessee's Employment Growth

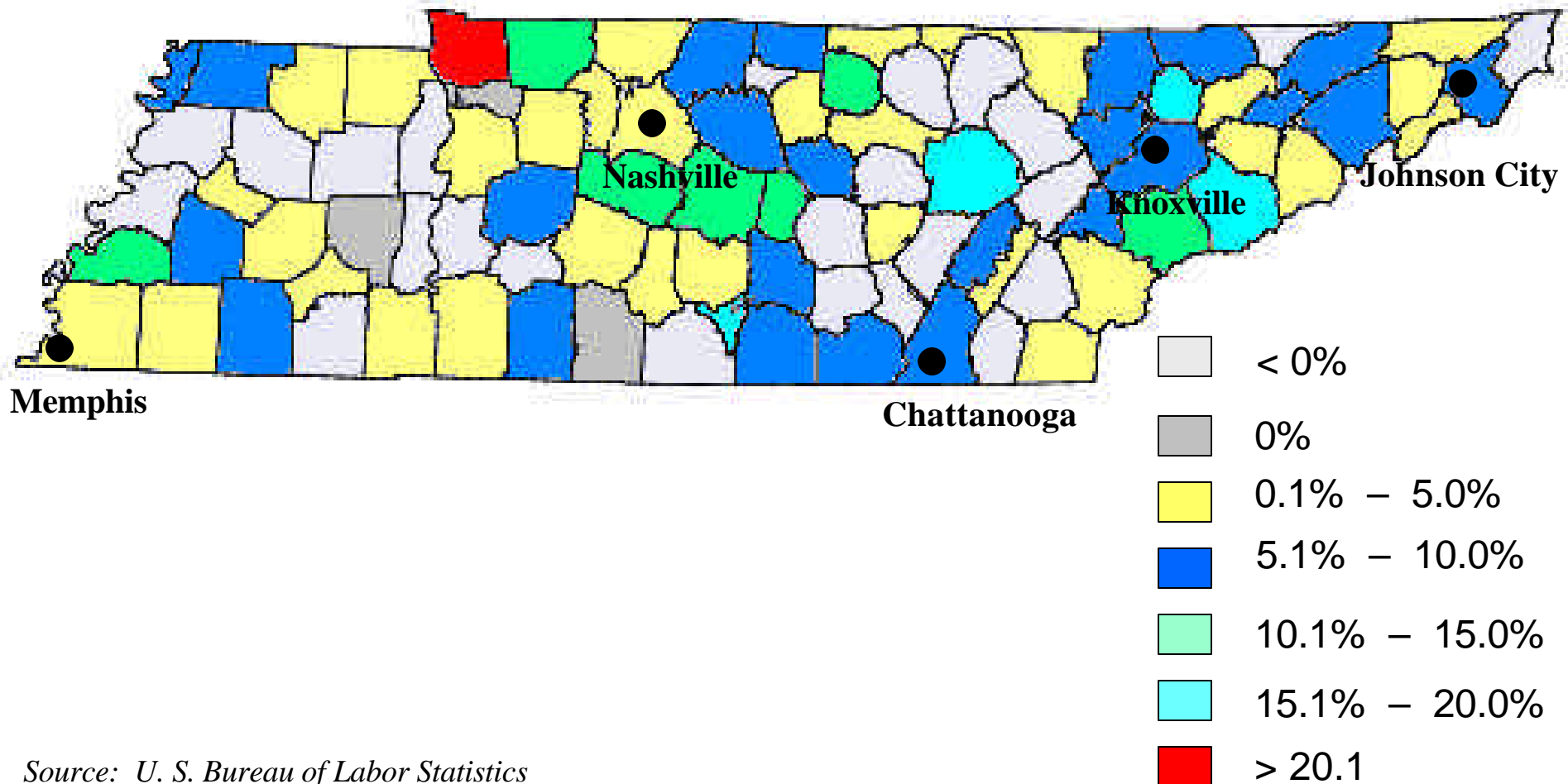
- Like most states, Tennessee has experienced a decline in non-farm employment, although not to the extent seen in other Southeastern states



Source: U. S. Bureau of Labor Statistics

Employment Growth by County

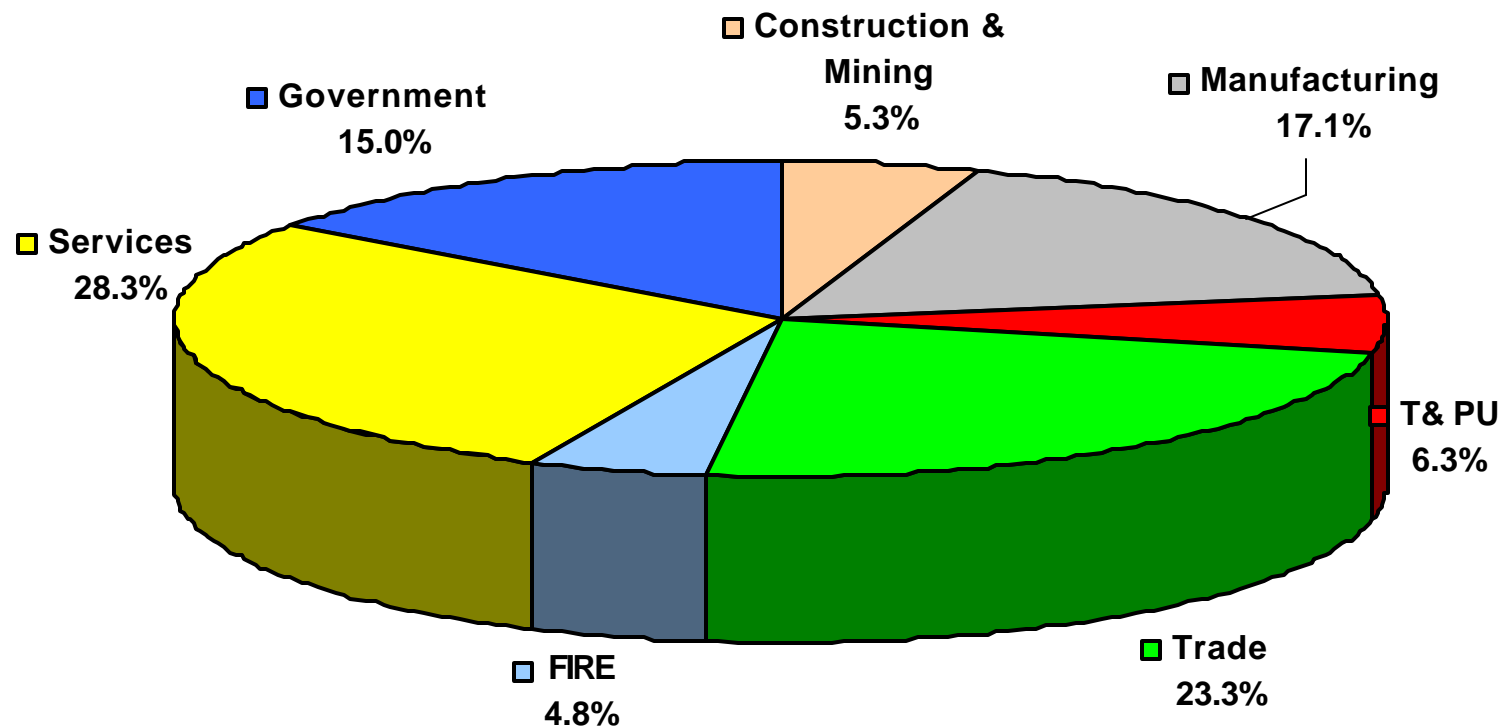
- Employment growth between 1998 and 2002 was fairly evenly distributed across the state



Source: U. S. Bureau of Labor Statistics

Employment by Industry

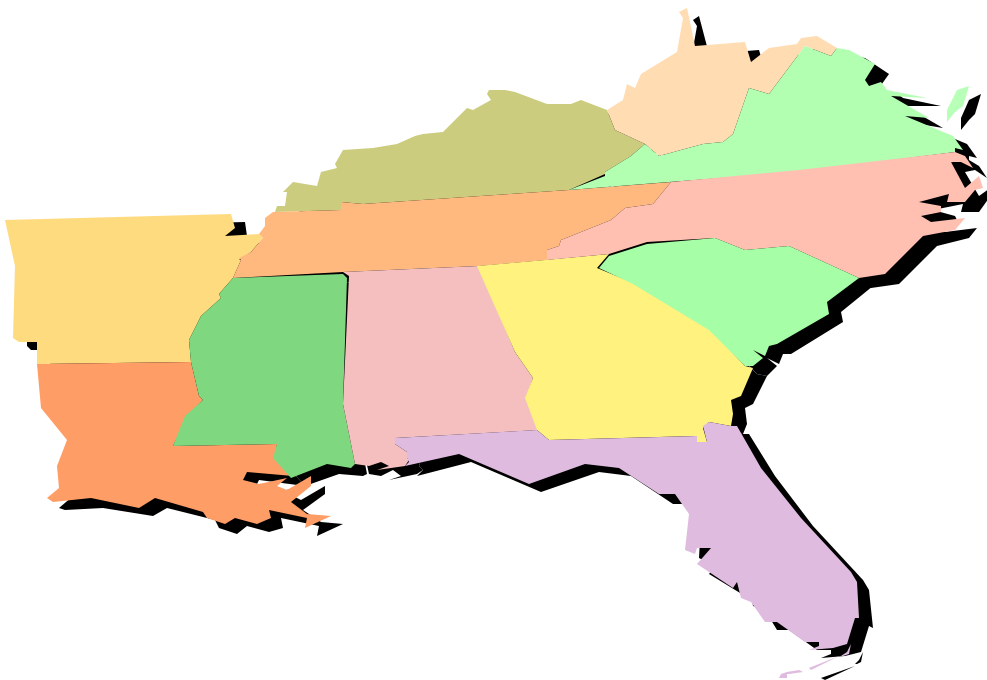
- Tennessee's employment base continues to be diversified and balanced



FIRE: Finance, Insurance and Real Estate
T & PU: Transportation and Public Utilities
Trade: Retail and Wholesale Trade

Employment by Industry

- Decreasing our reliance on manufacturing
- Existing manufacturing base not adversely impacted by recession as great the Nation's



State of Tennessee

	1998	1999	2000	2001	2002
Total, All Industries (In thousands)	2,638.3	2,685.3	2,728.9	2,688.3	2,666.2
Sectors in Percentages:					
Construction & Mining	4.8%	4.7%	4.8%	4.6%	5.3%
Manufacturing	19.5%	18.4%	18.6%	17.6%	17.1%
Transportation & Public Utilities	5.8%	5.0%	6.5%	6.6%	6.3%
Trade (Wholesale & Retail)	23.6%	26.9%	24.6%	23.5%	23.3%
Finance, Insurance & Real Estate	4.7%	5.2%	4.8%	4.9%	4.8%
Services	26.7%	25.4%	27.2%	27.8%	28.3%
Government	14.9%	14.5%	14.6%	14.9%	15.0%

(Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, West Virginia)

Southeast

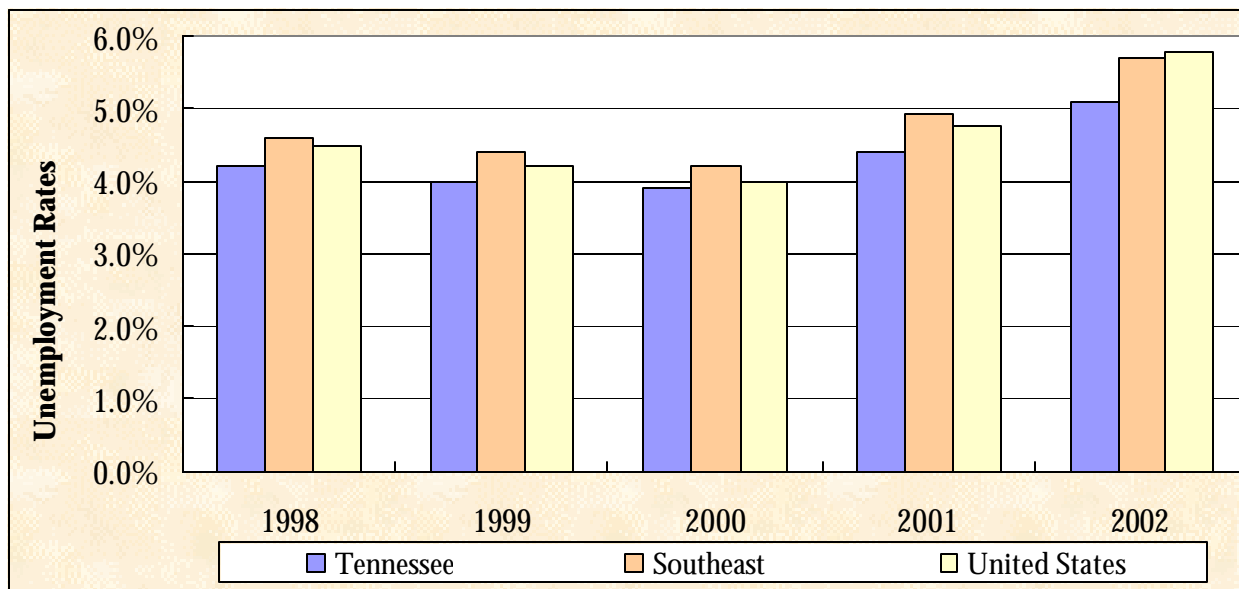
	1998	1999	2000	2001	2002
Total, All Industries (In thousands)	30,407.5	31,111.9	31,791.8	31,687.3	31,502.2
Sectors in Percentages:					
Construction & Mining	6.03%	6.05%	6.06%	6.12%	6.04%
Manufacturing	14.6%	14.0%	13.6%	12.7%	12.0%
Transportation & Public Utilities	4.0%	4.0%	4.0%	4.0%	3.9%
Trade (Wholesale & Retail)	16.5%	16.5%	16.4%	16.3%	16.2%
Finance, Insurance & Real Estate	5.0%	5.1%	5.0%	5.3%	5.4%
Services	24.9%	25.5%	25.9%	26.1%	26.0%
Government	16.4%	16.2%	16.2%	16.5%	16.9%

United States

	1998	1999	2000	2001	2002
Total, All Industries (In thousands)	125,865.0	128,916.0	131,720.0	131,922.0	130,791.0
Sectors in Percentages:					
Construction & Mining	5.25%	5.39%	5.46%	5.50%	5.44%
Manufacturing	14.9%	14.4%	14.0%	13.4%	12.8%
Transportation & Public Utilities	5.3%	5.3%	5.3%	5.4%	5.2%
Trade (Wholesale & Retail)	23.1%	23.1%	23.0%	23.0%	22.9%
Finance, Insurance & Real Estate	5.9%	5.9%	5.8%	5.8%	5.9%
Services	29.8%	30.3%	30.7%	31.1%	31.5%
Government	15.7%	15.7%	15.7%	15.9%	16.3%

Unemployment in Tennessee

- In recent years, the State's unemployment rate has been below the Southeast and the Nation's.



Source: U. S. Bureau of Labor Statistics

Total Non-Farm Employment Growth

	Tennessee	Southeast	United States
1998	2.1%	2.8%	2.6%
1999	1.8%	2.3%	2.4%
2000	1.6%	2.2%	2.2%
2001	1.5%	-0.3%	0.2%
2002	-0.8%	-0.6%	-0.8%

Source: U.S. Census Bureau



Private Sector Employment Base

- More than 108,000 businesses currently operating in TN
- 100+ Fortune 500 companies with a significant presence in TN
 - 8 Fortune 500 companies headquartered here, including a new addition announced last week – Caremark Rx
- More than 700 companies with 500+ employees

Company	Number of Employees
Wal-Mart Associates, Inc.	32,000
Federal Express, Inc.	30,000
Kroger Limited Partnership, Inc.	15,500
Vanderbilt University / Hospital	13,700
Eastman Chemical Company	11,100
United Parcel Service	8,600
Saturn Corporation	8,400
Methodist Health Care Memphis	7,900
U. S. Xpress	7,300
Nissan Motor Mfg. Corp. USA	6,300
Sear Roebuck & Company	6,200
Gaylord Entertainment Co.	6,100
Kmart Corporation	5,900
Randstad Staffing Services, USA Inc.	5,900
Bellsouth Telecommunications Inc.	5,800
First Tennessee Bank	5,700
UT-Battelle (Facilities Support Services)	5,500
HCA - The Healthcare Co.	4,998
J. C. Penney & Co. Inc.	4,900
Baptist Memorial Hospital	4,900
Carson Pirie Holdings (Saks)	4,900
Cracker Barrell Old Country Stores	4,700
Amsouth Bancorp	4,600
Covenant Transport Inc.	4,400
K-V-A-T Food Stores	4,400

Source: Comprehensive Annual Financial Report



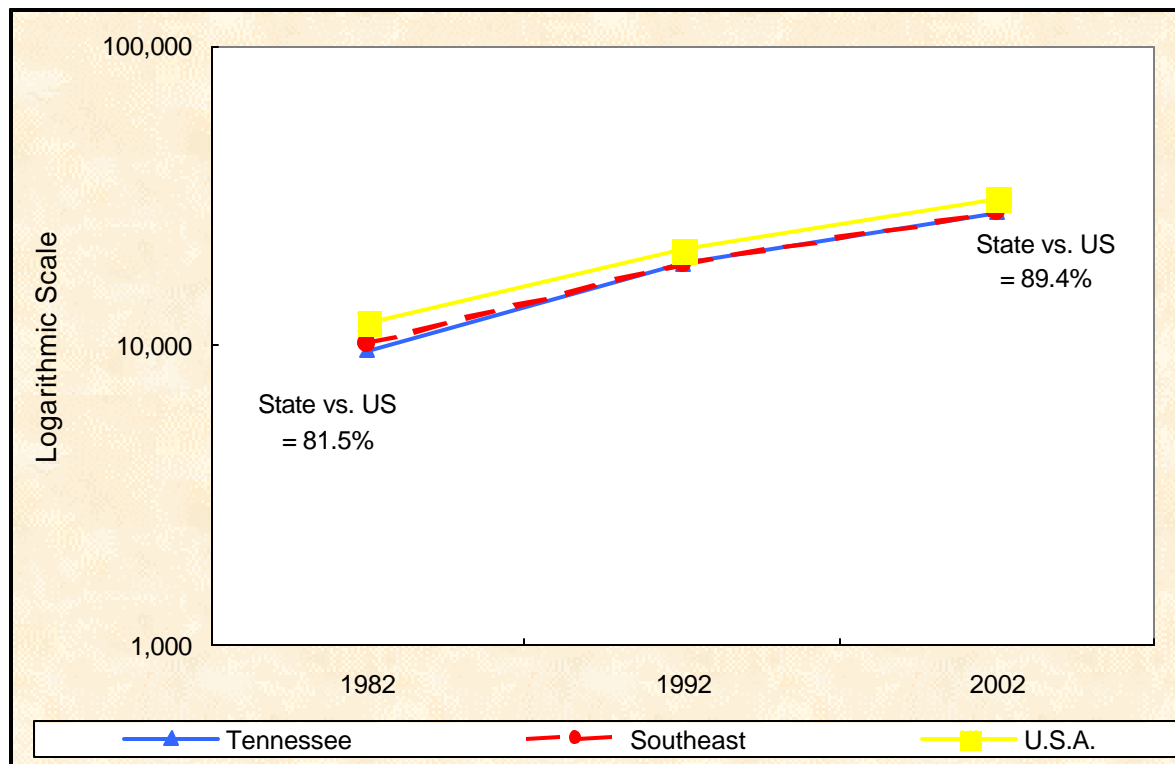
Public Sector Employment Base

- Public sector employment is spread across the State in many different Agencies

Public Entity	Number of Employees
State of Tennessee	45,000
Tennessee Board of Regents & UT System	22,886
United States Government (Memphis)	14,860
Memphis City Board of Education	14,402
Department of Energy	13,682
Metro Nashville Davidson County Board of Education	10,500
Metro Nashville Davidson County	9,500
Knox County Public Schools	7,230
Hamilton County Dept. of Education	6,793
Shelby County Government	6,700
Memphis City Government	6,680
Shelby County Board of Education	5,014
Naval Support Activity Memphis	4,500
Internal Revenue Service (Memphis)	3,500
U. S. Postal Service (Memphis)	3,500
City of Knoxville	3,500
Tennessee Valley Authority	3,338
City of Chattanooga	2,627
Memphis Light, Gas & Water	2,615
Knox County	2,500

Income Growth

- While historically Tennessee has been viewed as a low income state, that is changing
 - Over the past 20 years, the average per capita income has increased so that Tennessee is now in line with the Southeast average and only 10% below the National average





Employment Outlook Strong

- Clear roadmap for long-term economic development program
 - Short-Term:
 - Jobs Cabinet designed to insure consistent, all-hands-on-deck approach
 - Study underway to help redirect recruitment strategy
 - Regional economic development strategies in development – designed to expand urban development as well as jump-start rural development interests
 - Continue to maintain strong incentive options, specifically in the areas of infrastructure investment and job training support
 - Long-Term:
 - Working to better align education resources toward job market demands
 - Building on Tennessee's reputation for having one of the most developed business infrastructures (i.e. fiber optic networks and digital switches, wet labs to support research initiatives)
 - Working to leverage growth areas



Employment Outlook Strong

- Promising track record from first quarter
 - Eight major jobs announcements since January
 - 2,400 new jobs created
 - Jobs that fit socio-educational needs of individual communities
 - Generally speaking, well paying jobs

TOYOTA



ASURION



DURA
Automotive Systems





Laying the Foundation:

The FY03-04 Budget



Overview of FY03-04 Budget

- Back to basics budget
 - Balanced
 - Responsible
 - No short-term fixes – permanent cuts
 - Unlike other states, no accounting gimmicks
 - Recurring to recurring
 - Passed without the political discord seen over last several years in Tennessee



The Bottom Line

- To get to the right bottom line, we took a conservative approach on both the revenue and expense sides of the equation

+ REVENUE

- Conservative approach to revenue projections
- Using consensus growth rate in revenues

- EXPENSES

- Across the board cuts to get spending in line with available revenue
- Fiscal restraint and focus in terms of new spending
- Truth in budgeting practices (i.e. TennCare, health benefit increases)



The Bottom Line

- There is little growth in the State's budget between FY 02-03 and FY 03-04

	<u>FY 02-03*</u>	<u>FY 03-04</u>
Total state appropriations	\$9.8B	\$9.8B
Total federal funds	\$8.3B	\$8.3B
Other	\$3.4B	\$3.4B
Total Budget	\$21.5B	\$21.5B

** Includes non-recurring revenue*



FY02-03 General Fund Fiscal Results

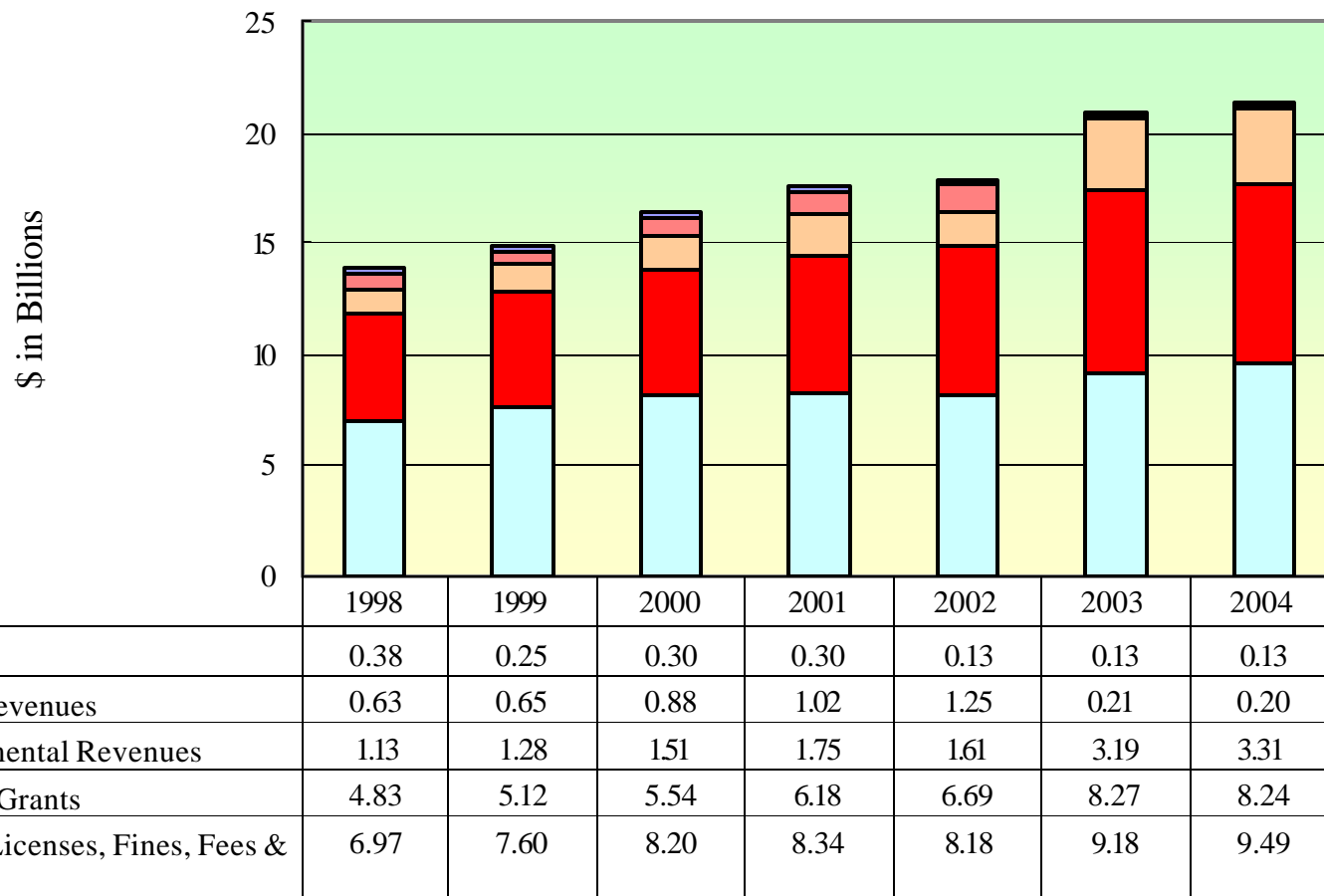
(\$ In Millions)

Projected Deficit	
Shortfall	\$ (250.8)
Plan for Closing	
2001-2002 Closing Balance	\$ 11.3
2002-2003 DSRF Transfer	28.0
Appropriation Reversion	64.3
Federal Contingent Liability	50.0
Highway Transfer Fund	30.0
Sub-Total	\$ 183.6
Rainy Day Fund	67.2
Total	\$ 250.8



Revenue Trends

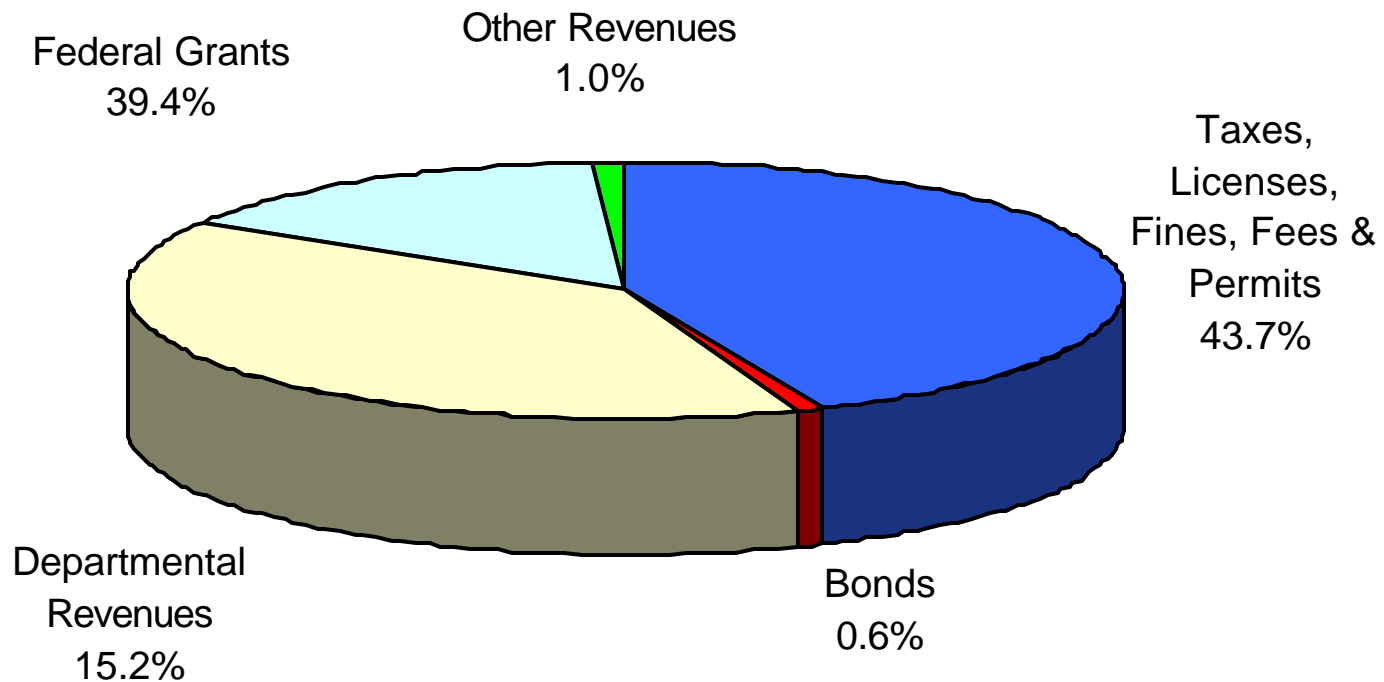
- Overview of revenue sources



Revenue Trends

- While the sales tax remains the state's major revenue source, Tennessee's tax base remains diversified

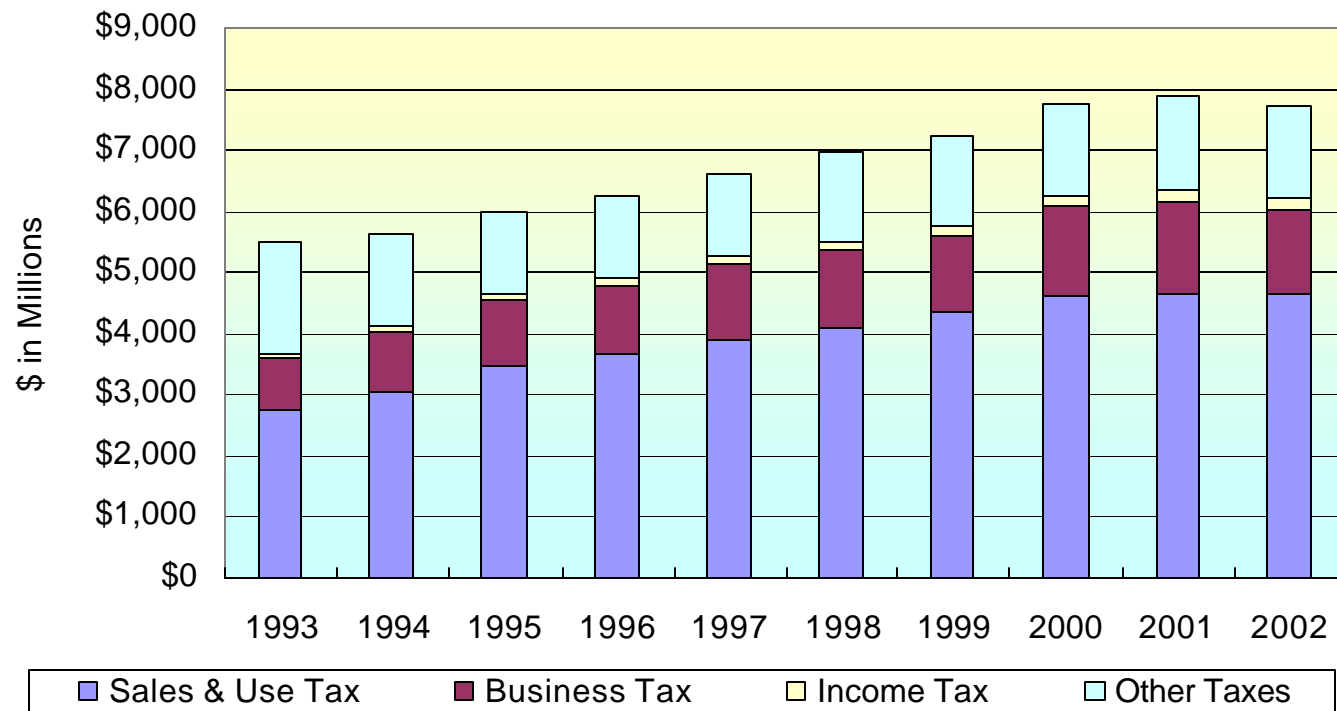
FY2003



Revenue Trends

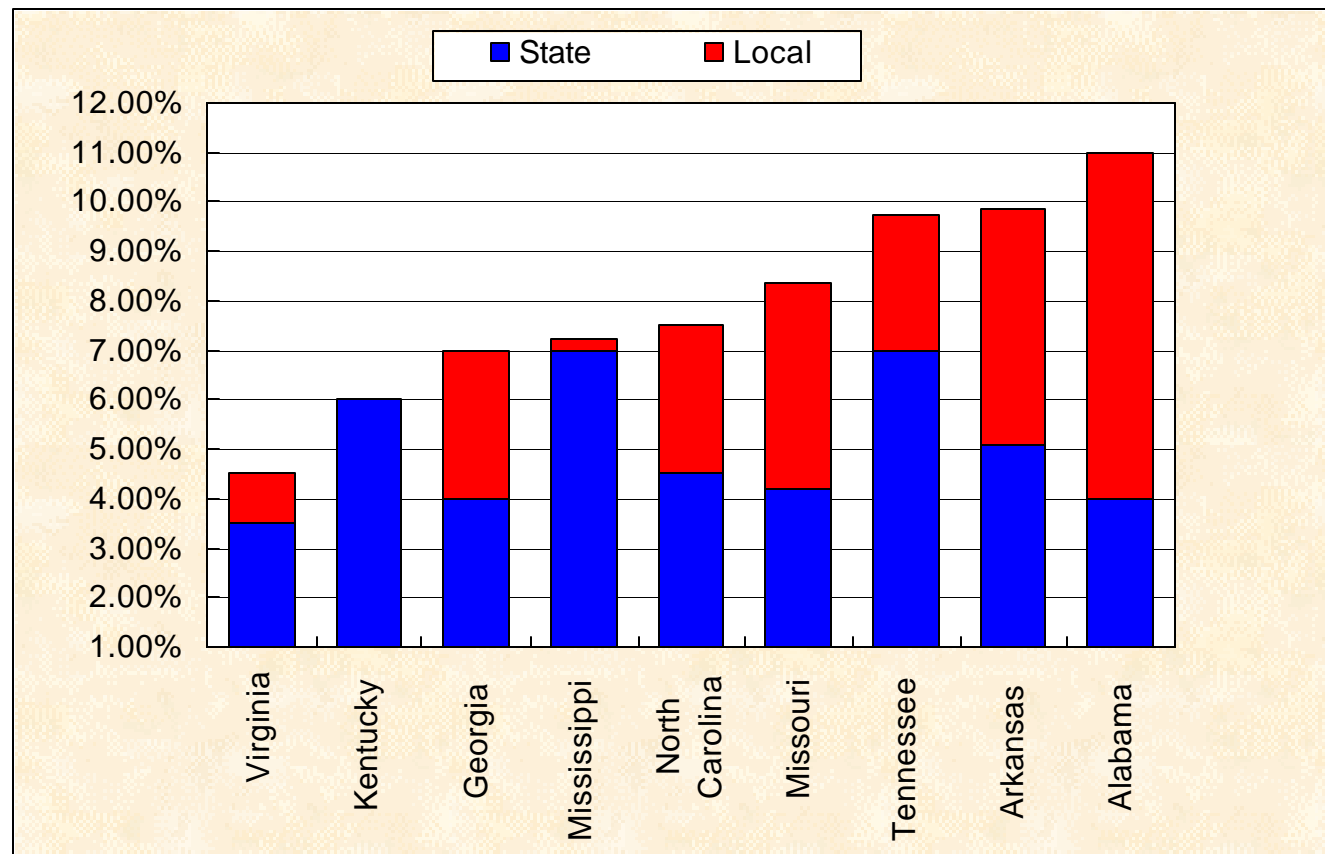
- Tax Collections

- The retail sales and use tax, imposed in 1947, is the State's leading source of revenue
- The current sales tax rate of 7% was made effective June 2002
- Franchise & Excise tax underperforming



Revenue Trends

- Tennessee's sales tax rate is high relative to its bordering states. Yet at the same time, Tennessee has one of the Southeast's lowest overall per capita tax burdens



Source: Sales Tax Institute web-site: www.salestaxinstitute.com/sales_tax_rates.html

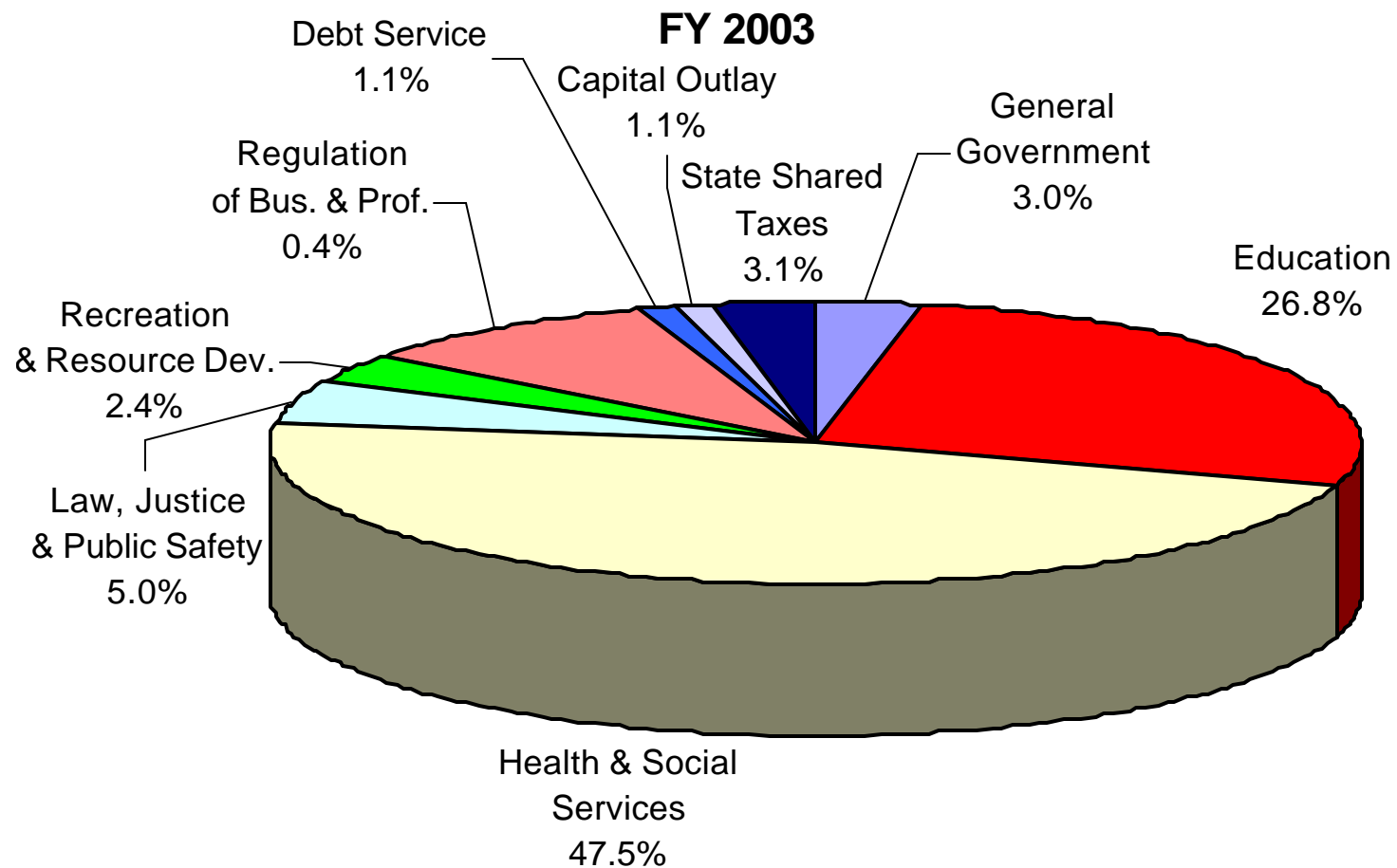


Expenditures

- Unlike many states, Tennessee preserved and in fact increased K-12 education spending
 - Fully funded Tennessee's Basic Education Program (BEP), \$33M
 - Downpayment on teacher pay equity issue, \$29M (Governor's task force working on long-range, multi-year plan now)
- New investments in safety/security
 - \$9.8 M in homeland security/public safety improvements
- Calibrated investments to get state out from under control of the courts
 - Brian A. settlement, \$5.5M
 - Mental Retardation – community service, \$9.9M



Expenditure Trends





Other Key Budget Actions/Issues

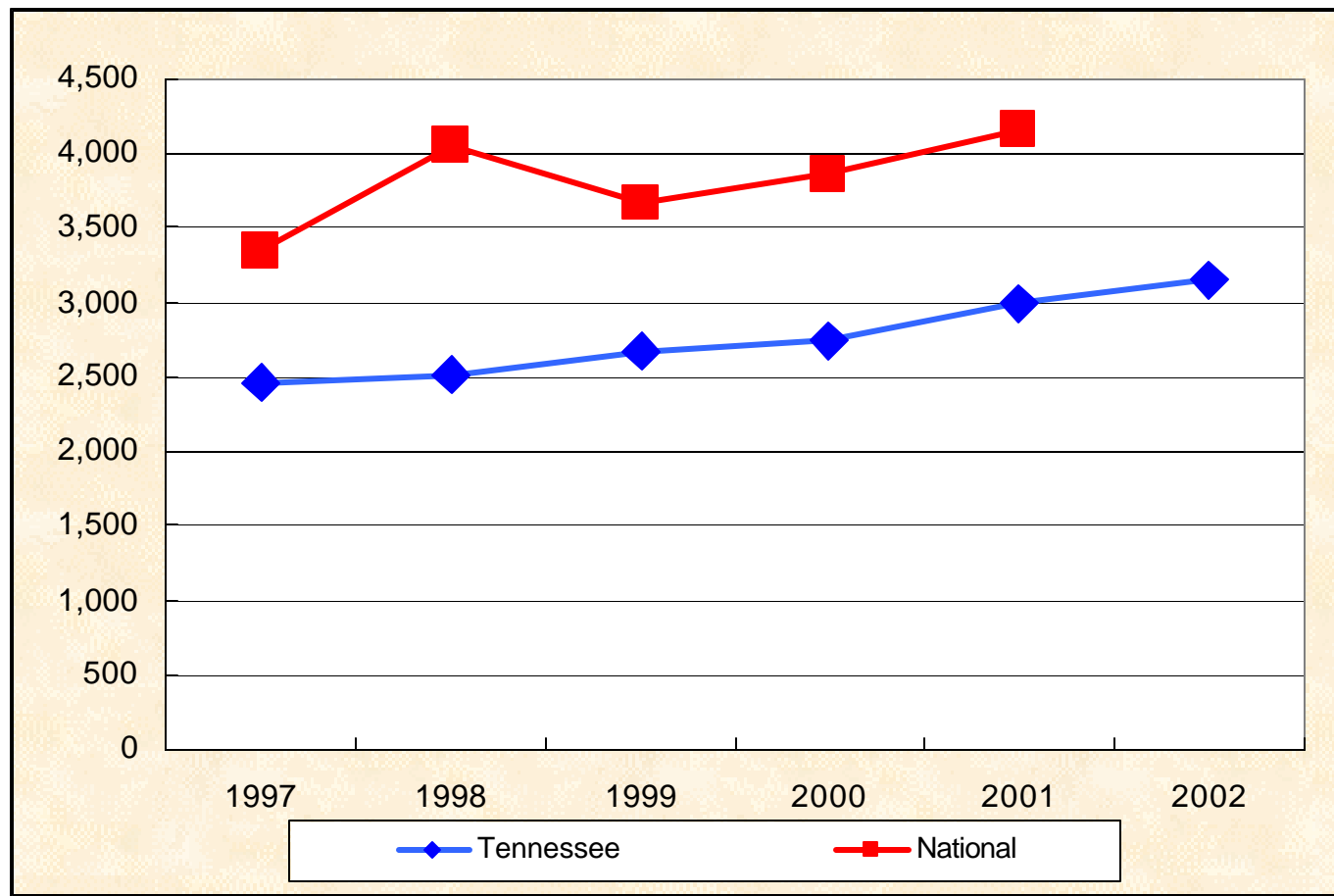
- Began addressing needed changes in business tax structure
 - Streamline Sales Tax passed
 - Bank tax loophole closed
- Impact of state share tax cuts to local governments calibrated
 - Philosophy based on need for pain to be spread evenly
 - No one group shouldering more or less of the burden
 - Ultimately, the General Assembly approved only a 6% cut in state shared revenues
 - Fuel tax distribution remains unchanged
 - TVA in-lieu-of-tax payments remain intact
 - Other protective measures put in place to minimize impact on local governments
 - Given new investments in education, many cities and counties actually have a net gain



Putting the FY03-04 Budget in Context

TN Expenditures in Nat'l Context

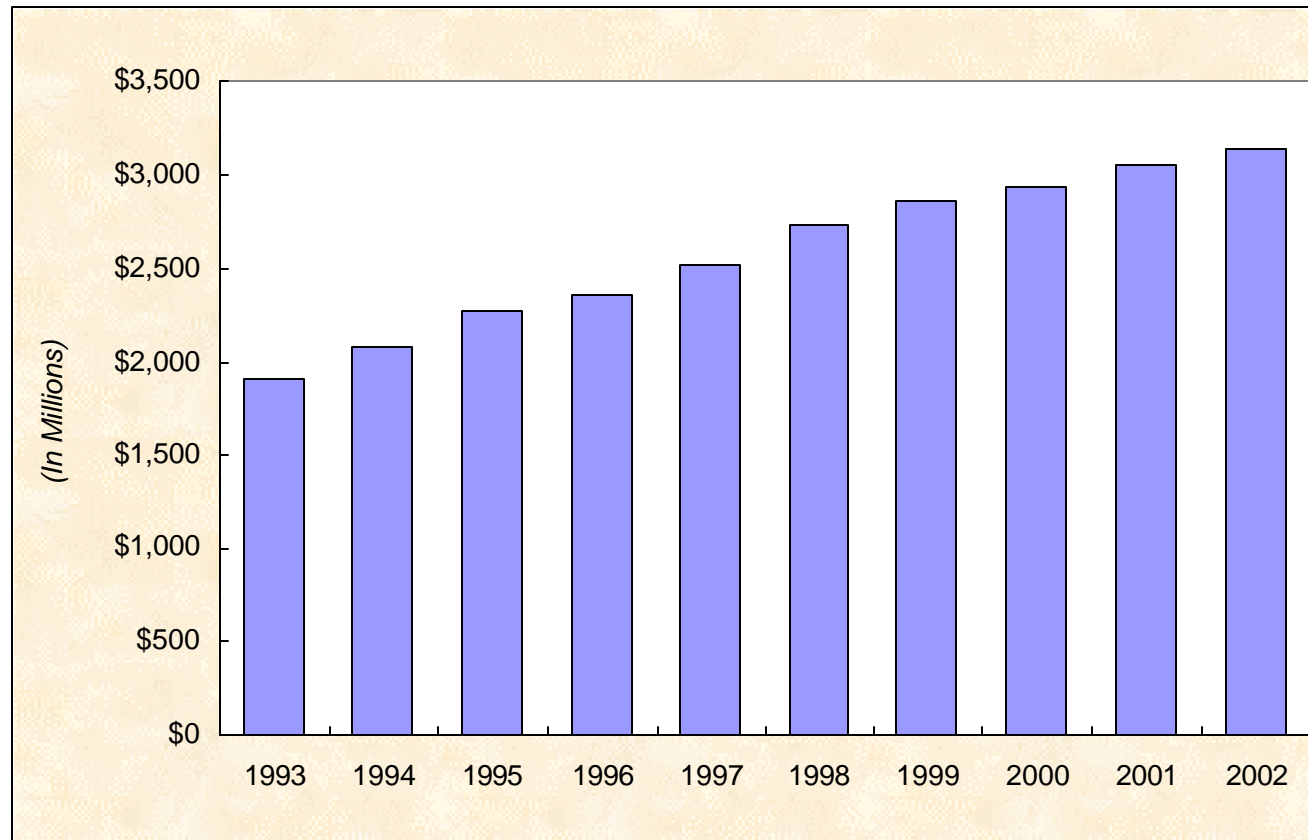
- Tennessee's per capita state governmental expenditures continue to be below the national average



National Average data collected from the U.S. Census Bureau's website: <http://www.census.gov/govs/www/state.html>

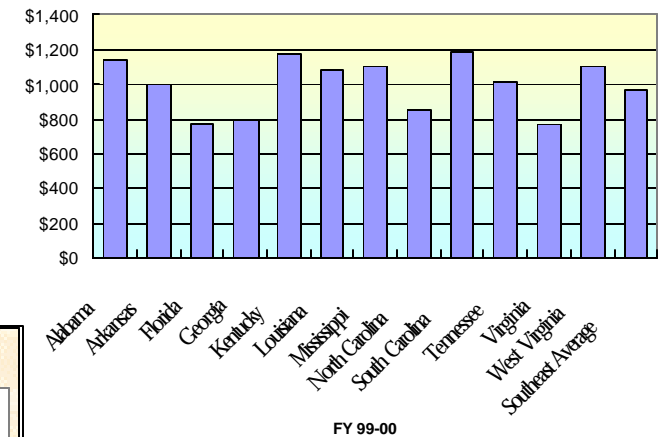
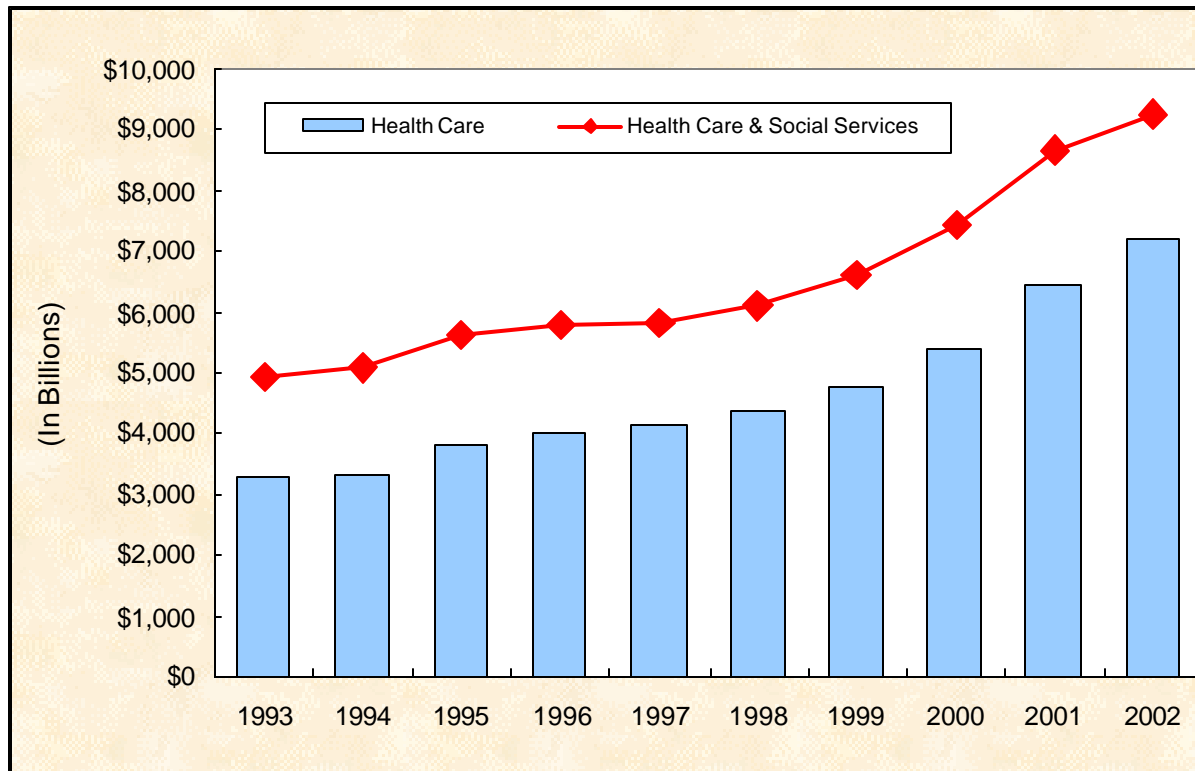
Education

- Tennessee continues to invest in public education
 - K-12 a priority this year although ultimately, higher education must also be part of this equation



Health Care and Social Services

- Investment in health care and related social services continues to increase

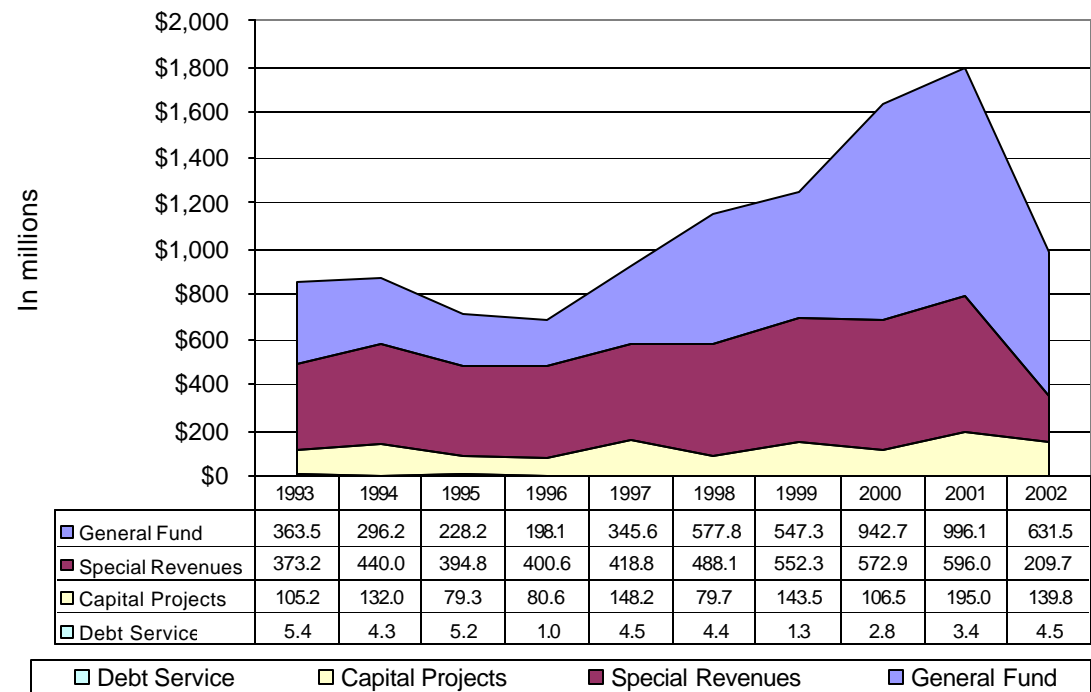


FY 99-00

Source: U. S. Census Bureau

Fund Balance

- Like many states, Tennessee's fund balance has declined significantly over the last several years. Aiming to rebuild in the coming years
 - \$193M in federal fiscal relief (half this FY, half next FY) all going to rainy day fund
 - \$197M generated from changes in TennCare waiver prevents further drain on rainy day fund
 - Working on long-term savings plan





Pension Fund Performance



Consolidated Retirement System

Actuarial Valuation

- Purpose: To determine employer contribution rate
- Performed every two years (July 2003)
- Actuarial Cost Method – Frozen Entry Age
- Asset Valuation Method – five year moving average of fair market value
- Economic Assumptions
 - Earnings – 7.5%
 - Salary – Graded, but approximates 5%
 - COLAs – 3.0%
- Actuarial audit was performed in 1999



Consolidated Retirement System

Actuarial Experience study

- Purpose: To establish economic and demographic assumptions
- Performed every four years (July 1, 2005)
- Demographic assumptions – based on actual experience
- Economic assumptions – based on future long-term expectations



Consolidated Retirement System

- Projection of next actuarial valuation results

As of June 30, 2003

Economic Assumptions

Earnings

Salary

COLA

Estimated Results

Actuarial loss

Actuarial gain

Actuarial gain

Demographic Assumptions

Turnover

Mortality

Retirement Pattern

Disability Pattern

Actuarial loss

Actuarial loss

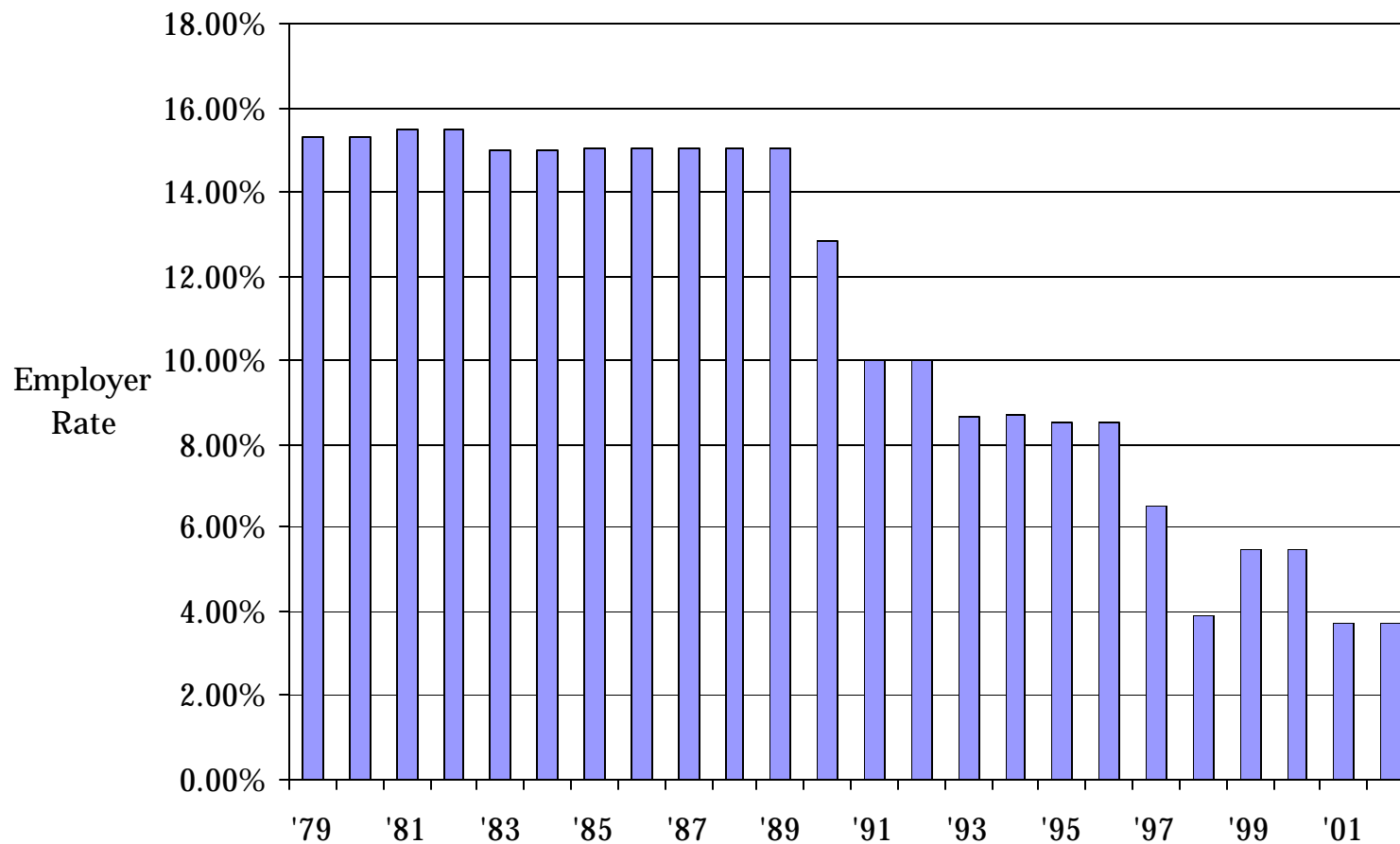
Actuarial gain

Neutral



History of Teacher Contribution Rates

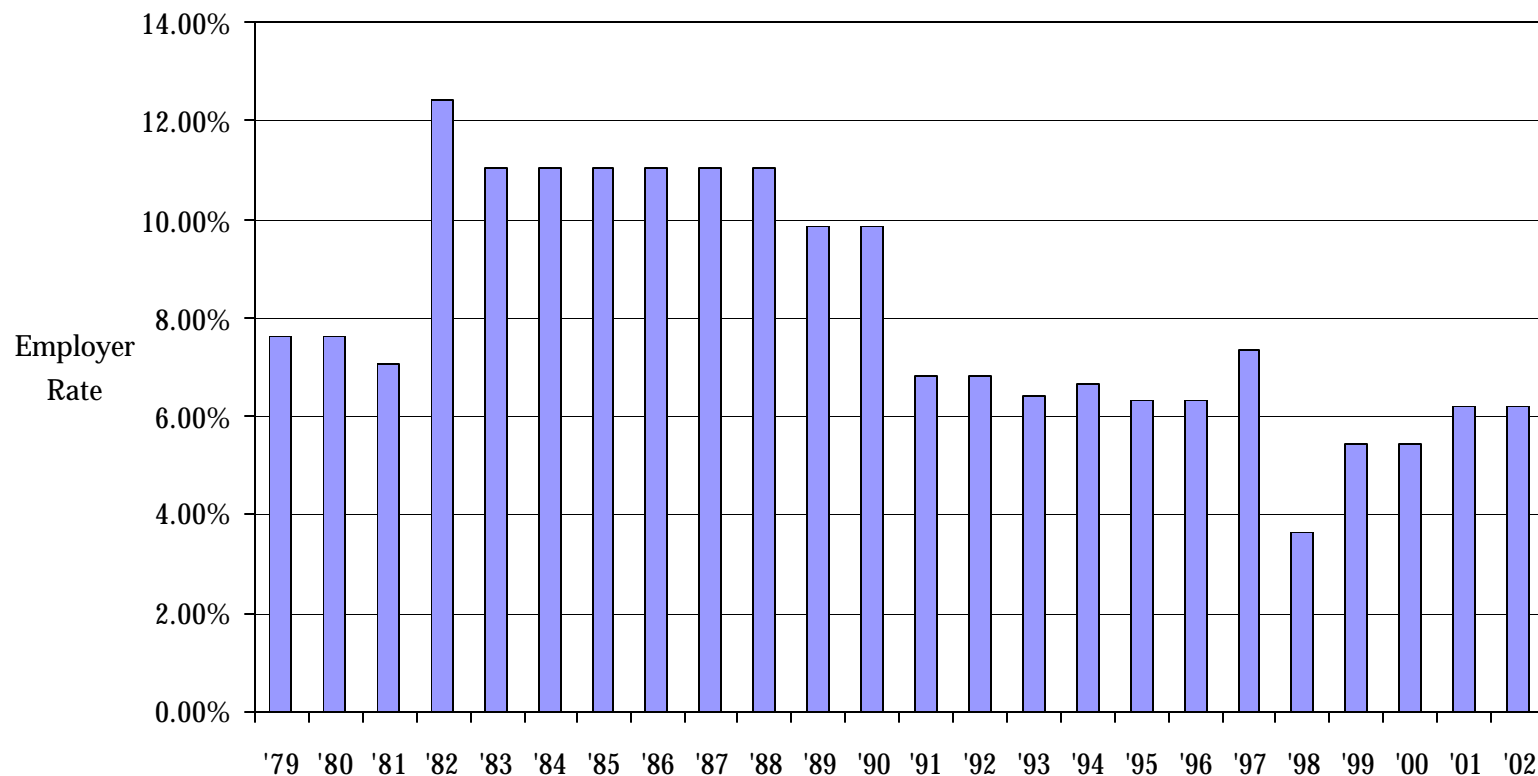
- The employer rate has dropped by over 75% since 1990





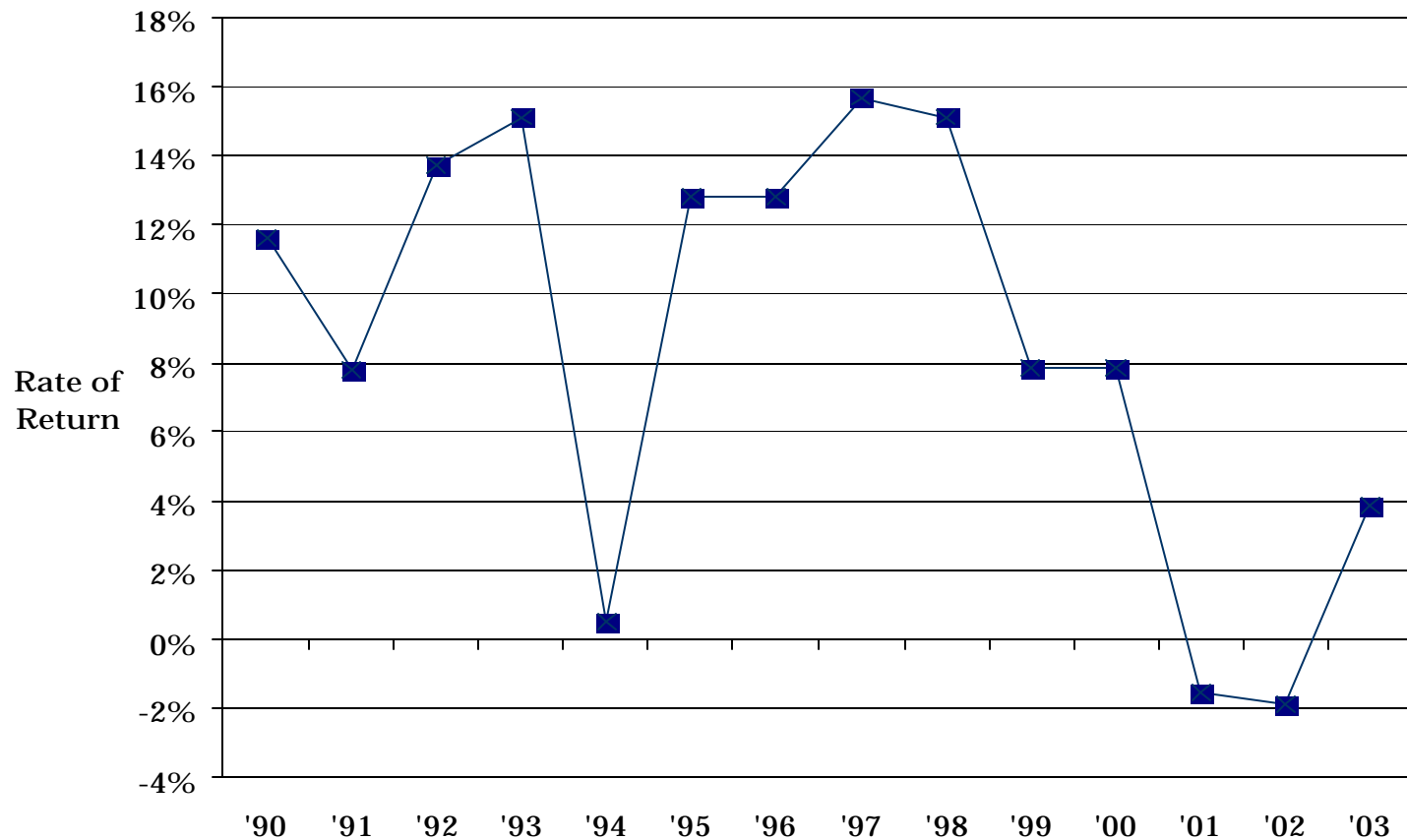
History of State Contribution Rates

- Current contribution rate for state employees remain well below historic averages



TCRS Rate of Return

- For the period ended June 30, 2002, the ten year average return exceeds 8%





Asset Distribution

- Distribution across investment allocation:

	March 31, 2003	
	Market Value	Percent
Domestic Equity	\$5,756,152,689	25.69%
Domestic Fixed-Income	\$11,137,858,241	49.71%
International Equity	\$1,900,017,453	8.48%
Int'l Fixed-Income	\$726,690,902	3.24%
Inflation Hedged Bond	\$1,431,290,219	6.39%
Real Estate	\$370,559,078	1.65%
Cash Reserves	\$1,084,865,982	4.84%
Total Fund	\$22,407,434,564	100.00%

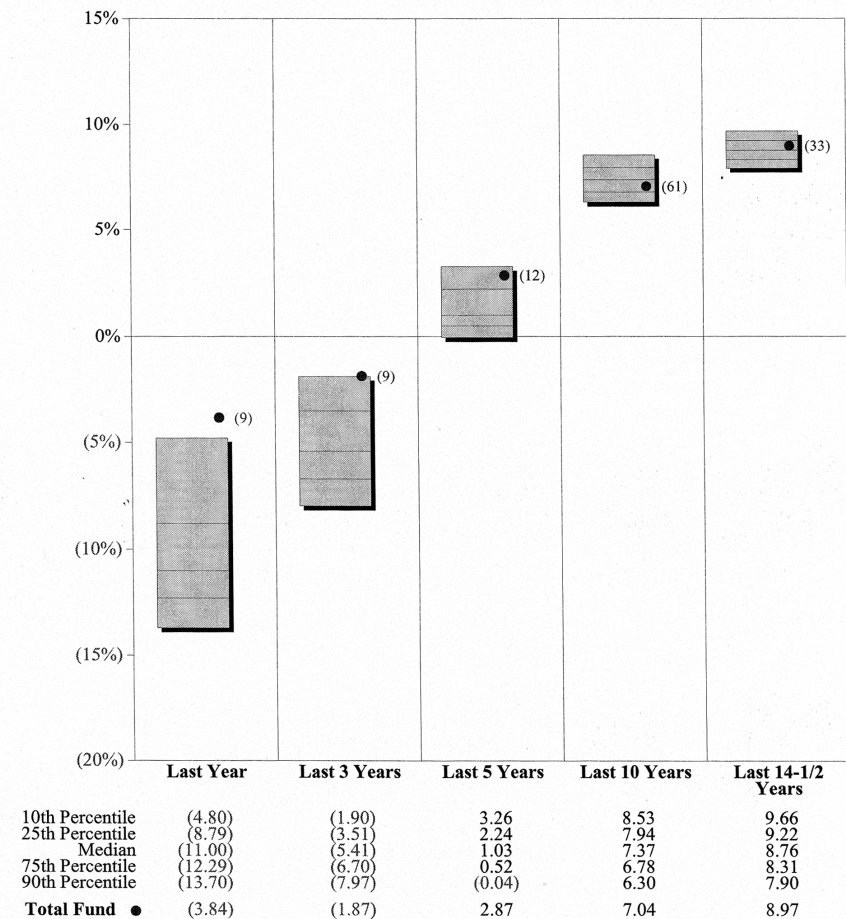
TCRS Performance

- TCRS has exceeded the median public plan return for the last year, the last three years and the last five years and was approximately equaled to the median for the past 14½ years

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM PERFORMANCE VS CAI PUBLIC PLAN SPONSOR DATABASE PERIODS ENDED MARCH 31, 2003

Return Ranking

The chart below illustrates fund rankings over various periods versus the CAI Public Plan Sponsor Database. The bars represent the range of returns from the 10th percentile to the 90th percentile for each period for all funds in the CAI Public Plan Sponsor Database. The numbers to the right of the bar represent the percentile rankings of the fund being analyzed. The table below the chart details the rates of return plotted in the graph above.



TCRS Performance

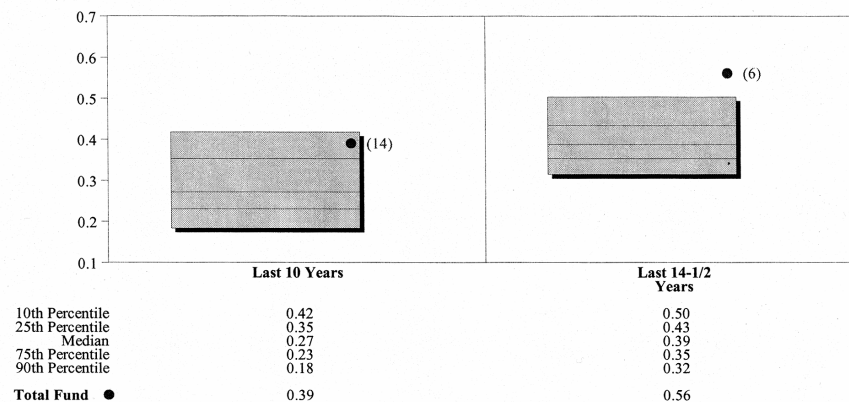
- The conservative asset allocation for the plan provided superior risk adjusted returns compared to the average public plans

RISK AND RISK ADJUSTED RETURN STATISTICS PERIOD ENDED MARCH 31, 2003

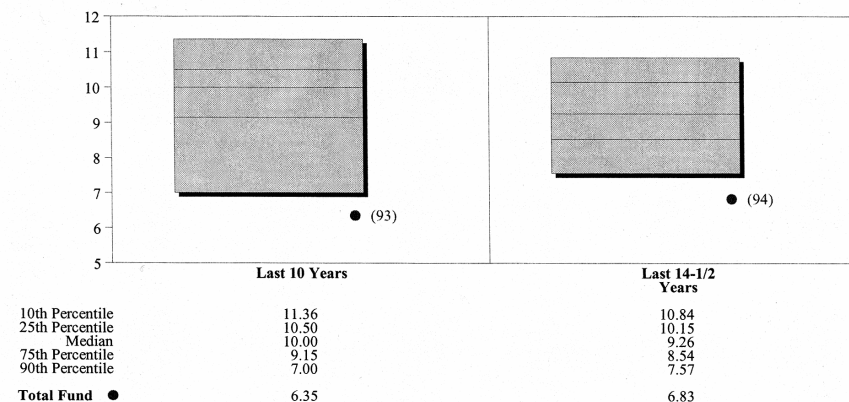
Risk Statistics

The Sharpe Ratio is a commonly used measure of risk-adjusted return, calculated by subtracting the Risk-free Return from the portfolio return and dividing the resulting "excess return" by the portfolio's standard deviation. The result is a measure of return gained per unit of total risk taken.

Sharpe Ratio vs. CAI Public Plan Sponsor Database



Standard Deviation vs. CAI Public Plan Sponsor Database



TCRS Performance

Pensions & Investments

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Returns

Continued from page 1

informal survey of 72 public pension funds — ranging in size from more than \$140 billion to slightly less than \$800 million — showed similar results. The median return among those plans for the year ended June 30 was -5.83%. The returns ranged from -15.1% at the Arizona Public Safety Personnel Retirement System, Phoenix, to 0.93% at \$21 billion South Carolina Retirement System, Columbia.

Fixed income boost

South Carolina was the only public fund among those surveyed by P&I that managed to eke out a positive return. It did so based largely on its 73% allocation to fixed-income investments, spokesman Brent Weaver said.

"We were late getting to the dance on the equities side," Mr. Weaver said. "In 1995 we changed the state constitution to allow for investments in equities, and since then we've been working into it slowly." South Carolina had 27% of its \$21 billion in assets in equities as of June 30, Mr. Weaver said.

The Tennessee Consolidated Retirement System, Nashville, had the second-best return among the funds surveyed, returning -1.9% in the year ended June 30. The \$23 billion fund has a target allocation of 45% equities. Chief Investment Officer Tom Milne said that thanks to the recent market slide, the fund's actual equity allocation on June 30 was probably closer to 38%. The bulk of the rest of the assets — 52% — is in fixed income. The fund has 8% in cash and almost 2% in real estate, Mr. Milne said.

PUBLIC KNOWLEDGE

Returns of selected public funds for periods ended June 30.

FUND	FY2002 RETURN	3-YEAR RETURN	5-YEAR RETURN
South Carolina Retirement	0.93%	4.24%	5.94%
Tennessee Consolidated	-1.92%	1.36%	5.58%
New Mexico Public Employees	-2.07%	2.31%	7.91%
West Virginia Investment	-2.50%	1.90%	4.30%
City of Jacksonville	-2.50%	2.10%	8.80%
Indiana State Teachers	-2.60%		
Nevada Public Employees	-2.65%	1.05%	5.76%
Missouri Public School	-2.80%	0.90%	6.00%
Illinois Teachers	-2.90%	1.20%	6.10%
Hartford Municipal Employees ¹	-3.10%	1.10%	6.10%
Fairfax County Employee	-3.90%	0.60%	5.50%
Alabama Teachers ²	-3.99%		
Georgia Teachers	-4.00%	-0.70%	6.10%
North Carolina Retirement	-4.04%	0.79%	6.01%
Kentucky Teachers	-4.10%	-0.30%	5.70%
Indiana Public Employees	-4.50%	-0.20%	4.60%
San Francisco City & County	-4.50%	1.73%	6.55%
Alabama Employees & Judicial ²	-4.69%		
Kansas Public Employees	-4.70%	0.10%	5.40%
Vermont State Teachers	-4.70%	0.60%	5.80%
Wisconsin Investment Board (fixed fund)	-4.80%		5.50%
South Dakota Retirement	-4.90%	0.80%	6.90%
Iowa Public Employees	-4.94%	0.79%	6.48%
Utah Retirement Systems ³	-4.99%		
Hawaii Employees	-5.08%	-1.70%	4.00%
Pennsylvania School Employees	-5.10%	-0.40%	5.20%
Oklahoma Teachers	-5.10%	1.00%	7.00%
Oklahoma Public Employees	-5.10%	-0.60%	5.00%
Vermont State Employees	-5.10%	-0.40%	5.00%
Birmingham Retirement	-5.23%	-0.14%	6.71%
Milwaukee Employees	-5.30%	0.80%	6.30%
Alaska Public Employees	-5.48%	-0.49%	4.57%
Alaska Teachers	-5.49%	-0.49%	4.60%
New York State Common	-5.57%	0.05%	6.15%
Louisiana State Employees	-5.70%	-0.40%	3.80%
Texas Employees	-5.73%	-1.01%	4.56%
Arkansas Public Employees	-5.74%	-0.26%	4.46%
Washington State Investment	-5.87%	0.42%	5.80%
California State Teachers	-5.95%		

FUND	FY2002 RETURN	3-YEAR RETURN	5-YEAR RETURN
California Public Employees	-5.97%		5.40%
Illinois Municipal Retirement Fund ⁴	-6.00%	0.70%	5.60%
Nebraska Investment Council	-6.08%	-0.97%	4.99%
Arkansas Teacher Retirement System	-6.20%	-0.60%	5.10%
Delaware Public Employees	-6.30%		6.40%
Connecticut Retirement	-6.35%	0.70%	
Oregon Public Employees	-6.37%	1.03%	6.20%
New Hampshire Retirement	-6.40%	-0.90%	5.60%
Texas Teacher	-6.40%	-1.38%	5.45%
Mississippi Public Employees	-6.40%		
Massachusetts PRIM Board	-6.47%	0.48%	6.08%
New York State Teachers	-6.80%	-2.10%	5.40%
North Dakota Public Employees	-6.83%	-0.78%	4.64%
Wyoming Retirement	-6.90%	-1.18%	5.82%
Ohio Public Employees	-6.94%	-1.12%	4.22%
Idaho Public Employees	-7.07%	-4.00%	5.34%
Montana Teachers	-7.20%	-1.63%	4.51%
Montana Public Employees	-7.23%	-1.66%	4.46%
Virginia Retirement	-7.30%	-0.30%	5.60%
Maine State Retirement	-7.50%	-2.20%	4.10%
Louisiana Teachers	-7.60%	0.40%	5.70%
Maryland State Retirement	-7.60%	-2.20%	3.20%
State of Michigan Retirement	-7.80%	-0.80%	5.70%
Minnesota State Board	-8.00%	-2.20%	4.80%
Florida State Board	-8.07%	-2.11%	5.45%
New York City Retirement	-8.30%		
Rhode Island Employees	-8.30%	-3.70%	2.70%
Pennsylvania Public Employees	-8.60%	-0.30%	5.80%
New Mexico Educational	-8.70%	-2.65%	4.12%
North Dakota Teachers	-8.88%	-1.94%	3.61%
New Jersey Division of Investments	-9.00%	-3.10%	5.30%
Colorado PERA ⁵	-9.58%		
Minneapolis Teachers	-11.16%	-3.84%	3.00%
Arizona Public Safety Personnel	-15.07%		2.67%
AVERAGE	-5.83%	-0.35%	5.33%
Wilshire Associates TUCS (median return)	-5.82%	-0.30%	5.16%

¹RETURNS DO NOT INCLUDE REAL ESTATE. ²RETURNS DO NOT INCLUDE REAL ESTATE. ³WAGERS 6% OF THE PORTFOLIO. ⁴INVESTMENT PORTFOLIO. ⁵PERA 6% OF THE PORTFOLIO.

TCRS Performance

- State and teacher assets represent 87% of total plan assets

ACTUARIAL BALANCE SHEET

ACTUARIAL BALANCE SHEET as of July 1, 2001

	Political Subdivision Pension Plan (PSPP)	State Employees, Teachers, Higher Ed. Employees Pension Plan (SETHEEP)	Total
ASSETS			
Present assets creditable to			
Employer accumulation fund	\$ 2,595,966,677	\$ 18,122,409,253	\$ 20,718,375,930
Members' accumulation fund	592,023,782	2,638,579,836	3,230,603,618
Total present assets	<u>3,187,990,459</u>	<u>20,760,989,089</u>	<u>23,948,979,548</u>
Present value of prospective contributions payable to			
Employer accumulation fund			
Normal	562,004,620	1,858,475,622	2,420,480,242
Accrued liability	340,147,400	81,226,933	421,374,333
Total employer accumulation	<u>902,152,020</u>	<u>1,939,702,555</u>	<u>2,841,854,575</u>
Members' accumulation fund	<u>322,137,337</u>	<u>1,219,837,846</u>	<u>1,541,975,183</u>
Total prospective contributions	1,224,289,357	3,159,540,401	4,383,829,758
TOTAL ASSETS	<u>\$ 4,412,279,816</u>	<u>\$ 23,920,529,490</u>	<u>\$ 28,332,809,306</u>
LIABILITIES			
Present value of prospective benefits payable on account of			
Present retired members and beneficiaries	1,104,213,183	7,837,600,100	8,941,813,283
Present active members	3,223,007,501	15,723,108,792	18,946,116,293
Former members	85,059,132	359,820,598	444,879,730
TOTAL LIABILITIES	<u>\$ 4,412,279,816</u>	<u>\$ 23,920,529,490</u>	<u>\$ 28,332,809,306</u>

UNAUDITED

TCRS Performance

- TCRS has demonstrated consistent progress in its funded status

SUMMARY OF ACCRUED AND UNFUNDED ACCRUED LIABILITIES

SUMMARY OF ACCRUED AND UNFUNDED ACCRUED LIABILITIES

The unfunded accrued liability represents the excess of the accrued actuarial liability over the actuarial value of assets. For funding purposes, the Board of Trustees of TCRS has adopted the frozen initial liability method.

Under this method, the unfunded accrued liability is being funded by level-dollar contributions during an amortization period which ends in the year 2015. Also, actuarial gains and losses are absorbed in normal cost rather than as part of the unfunded liability. The statute governing TCRS allows the Board of Trustees to reestablish the unfunded accrued liability for actuarial gains and losses.

For the July 1, 2001 actuarial valuation, the Board reestablished the unfunded accrued liability. In an inflationary

economy where the covered payroll continues to grow, the level-dollar amounts which are being contributed to fund the unfunded accrued liability will, if expressed as a percentage of payroll, continue to decrease.

While concern is generally expressed regarding the dollar amount of the unfunded accrued liability, an analysis should also include the method being used to fund this liability as well as a review of this liability expressed as a percentage of active member payroll. The smaller the ratio of unfunded liabilities to the active member payroll, the stronger the system. A review of this ratio over a period of years will give an indication of whether the system is becoming financially stronger or weaker with respect to its unfunded liabilities.

SUMMARY OF ACCRUED AND UNFUNDED ACCRUED LIABILITIES

Dollar Amounts Expressed in Millions

Actuarial Valuation Year	Actuarial Accrued Liabilities (AAL)	Valuation Assets	Ratio Assets to AAL	Unfunded Actuarial Accrued Liabilities (UAAL)	Active Member Payroll	UAAL as a Percentage of Active Member Payroll
1991	\$ 11,066.4	\$ 9,409.4	85%	\$ 1,657.0	\$ 3,636.5	46%
1993 (3)	12,349.0	11,805.2	96%	543.8	3,943.1	14%
1995	14,434.8	14,027.0	97%	407.8	4,580.0	9%
1997 (4)	18,070.8	17,898.6	99%	172.2 (1) (2)	4,940.8	3%
1999	21,311.1	21,017.9	99%	293.2 (1)	5,473.8	5%
2001	24,370.4	23,949.0	98%	421.4 (1) (2)	5,997.0	7%

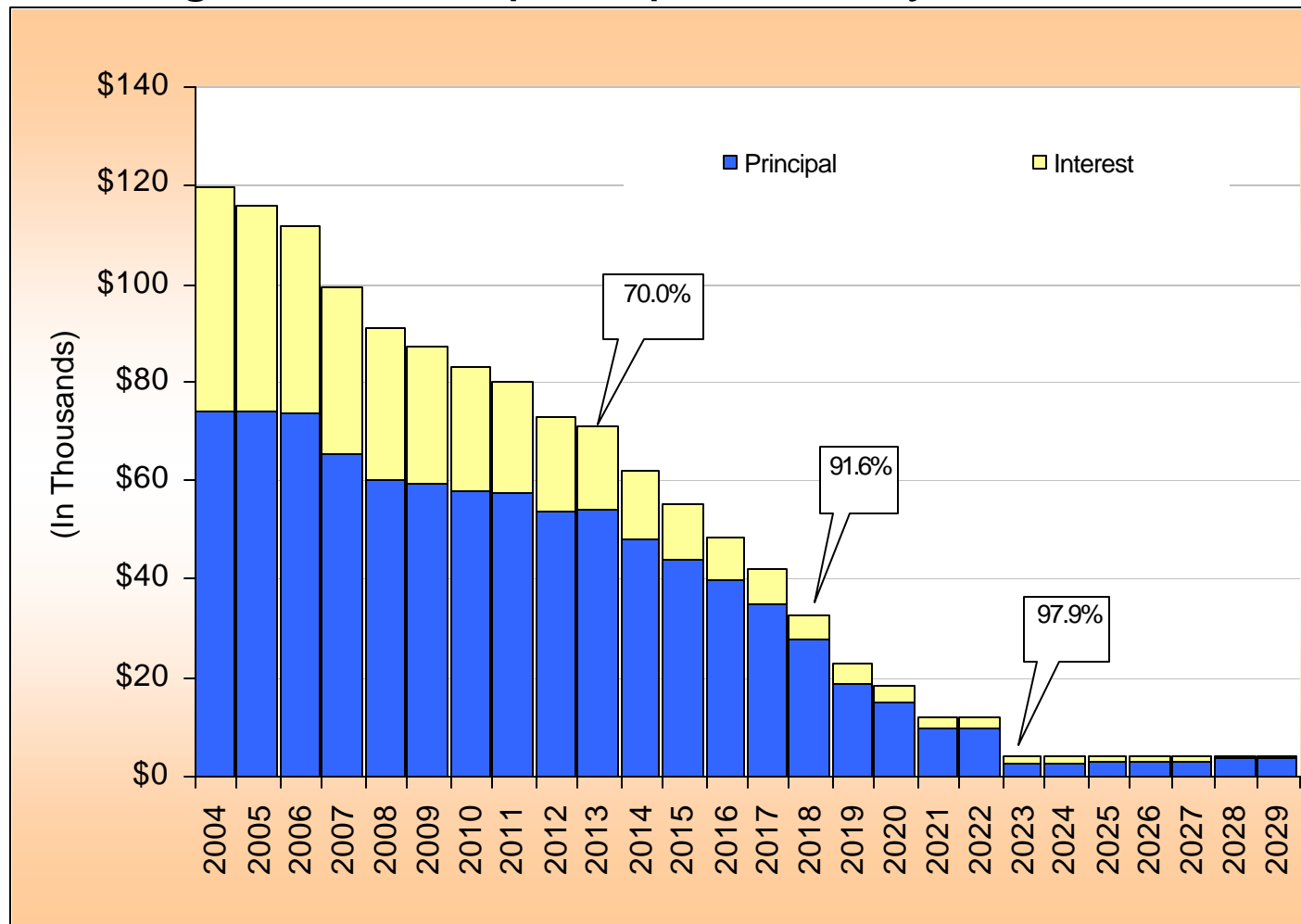
Notes: (1) Unfunded accrued liability was reestablished.
 (2) Includes adjustments for changes in actuarial assumptions.
 (3) Includes effect of five percent benefit improvement effective January 1, 1994.
 (4) Includes effect of compound COLA and 3.6% indexing improvement.



Tennessee's Debt Profile

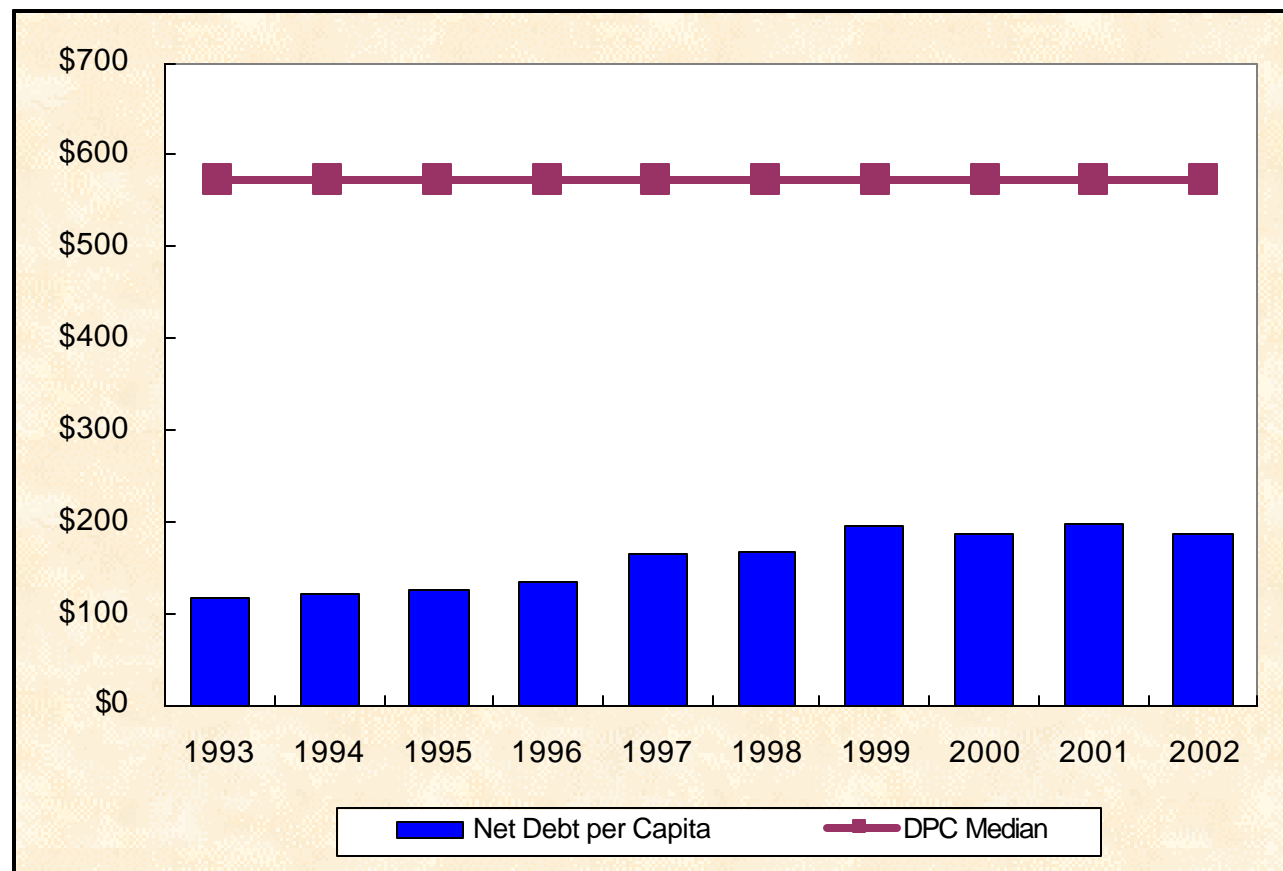
Existing Debt Structure

- Tennessee has an aggressive debt retirement rate—retiring 70% of its principal in ten years.



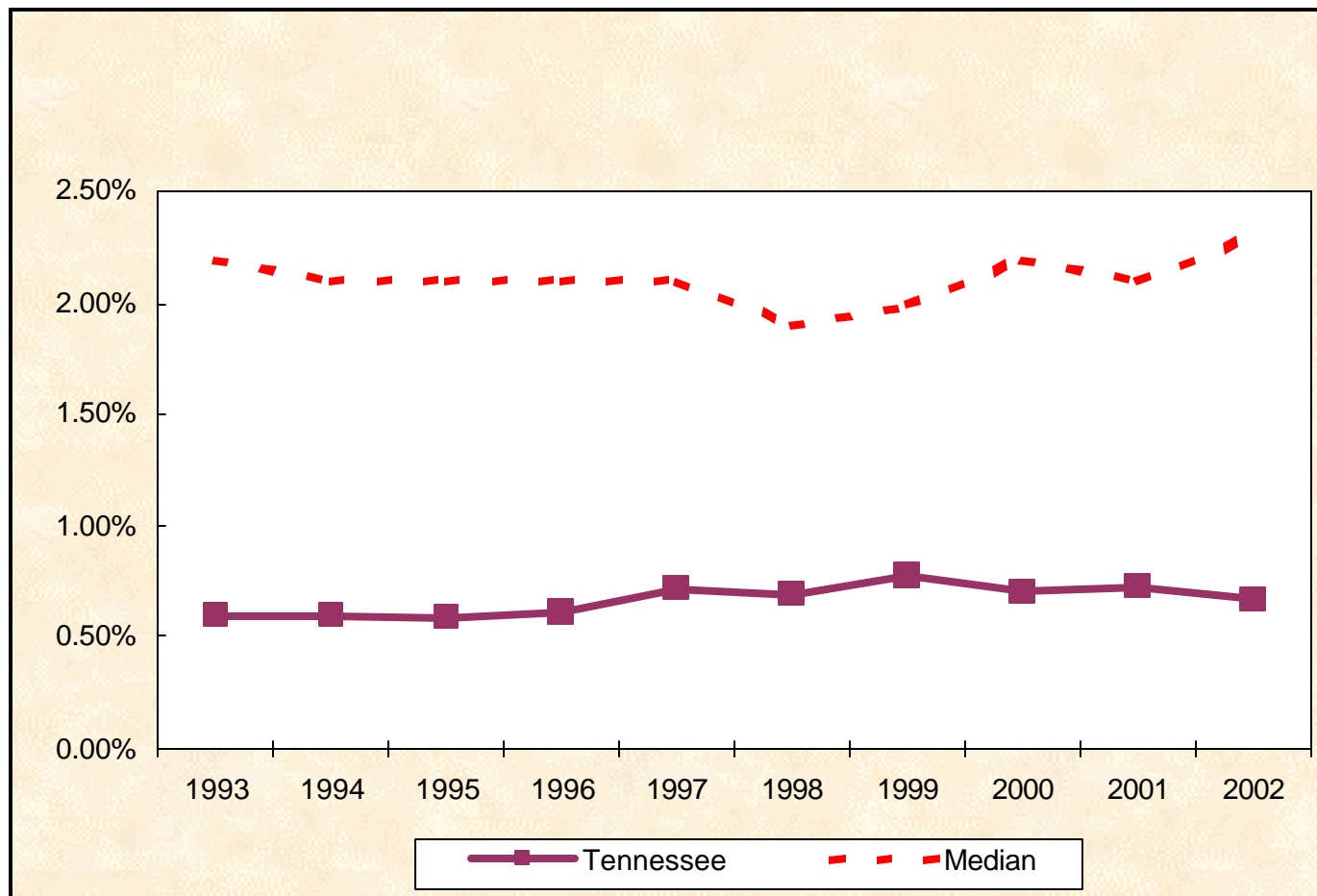
Debt Per Capita

- Tennessee's debt per capita is extremely low relative to state medians
 - The 45th lowest among all states



Debt Per Capita vs. Per Capita Income

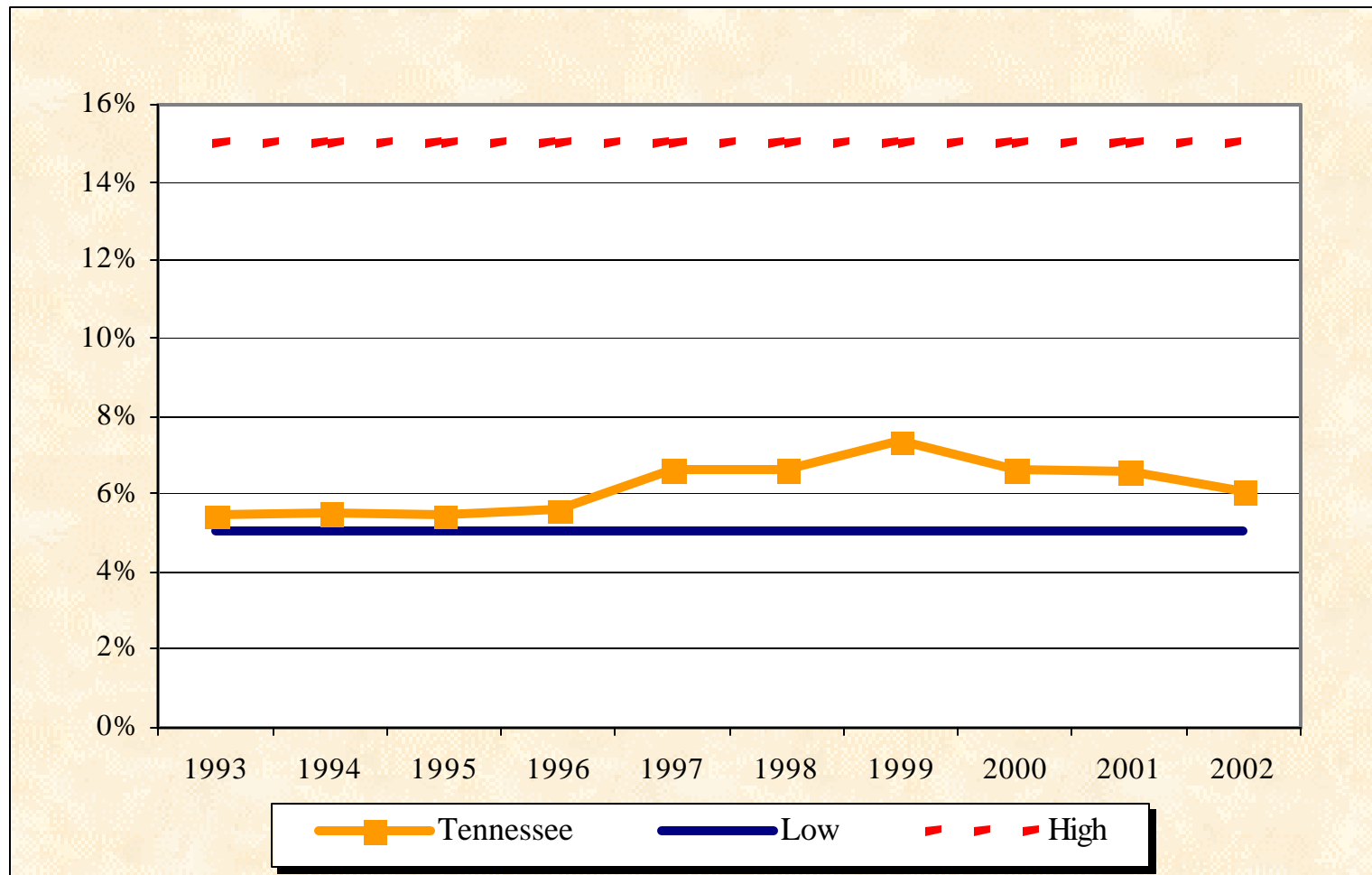
- Tennessee's debt per capita as a percentage of per capita income is very low relative to state medians





Debt Service as Percent of Expenditures

- Tennessee's debt service as a percentage of total expenditures is in the low end range





Looking Ahead



Issues on the Horizon

- Resolution of teacher pay equity
 - Lawsuit requires us to resolve inequities in teacher pay between rural and urban school districts
 - Avoided further fiscal stress by reaching cooperative agreement with all parties to proceed with a multi-year plan
 - Initial down payment included in this year's budget
 - Task force working on out years
- Reserves/fund balance
 - We recognize this is one of our real vulnerabilities although Tennessee's situation is not as dire as many other states
 - Working to slowly rebuild reserves/fund balance
 - All one-time federal relief being put toward recouping rainy day fund
 - Cabinet under mandate to come in under this year's budget
 - Working on long-term savings plan that would ultimately get our reserves closer to 5%



Issues on the Horizon

- Lottery
 - Scholarship and implementation guidelines passed by General Assembly this session
 - Conservative approach
 - Built-in safety mechanism for review/adjustment to fit actual revenues (funding board process)
 - Emphasis on strong ethical standards to prevent abuse
 - Built around national “best practices”
 - Tickets will go on sale next year
 - Expected to generate \$185-\$230M net revenue annually
 - Will fund college scholarships for public or private institutions (including community colleges and vocational training institutions)
 - Provides for small pilot program to assist with funding K-12 infrastructure projects



Conclusion

- Tennessee has a compelling story to tell
 - Continue to show signs of a strong, diversified economy
 - On most of the key economic indicators, we are at or above regional and national averages
 - Administration charting new fiscal course for the state with high standard for fiscal responsibility/discipline
 - FY 03-04 budget lays the foundation for disciplined spending plan moving forward
 - Economic development on steady, advancing course
 - Financial obstacles (i.e. TennCare) being dealt with head-on
- These changes put Tennessee on stronger fiscal footing and, we believe, Tennessee's rating outlook can be improved